Eurogas

2005 Annual Report

International energy projects

SPAIN Natural Gas Storage Development

TUNISIA Offshore Oil Development

Eurogas Corporation is a Calgary, Canada-based company whose common shares trade on the TSX-Venture Exchange under the symbol EUG. Eurogas is focused on creating long-term value through the development of high-impact energy projects. The Corporation is developing a major underground natural gas storage facility in Spain, and conducting exploration programs for oil and natural gas offshore Tunisia.

Contents

The Annual General Meeting will be held at 2:30 p.m. (Mountain Daylight Time) on Thursday, May 25, 2005 in the Viking Room of the Calgary Petroleum Club, 319-5th Avenue S.W., Calgary, Alberta, Canada. Shareholders are encouraged to attend. Those unable to attend should complete and return the form of proxy.

Letter to Shareholders

In 2005 Eurogas Corporation took a number of important steps towards the implementation of strategic plans to develop the Castor Underground Natural Gas Storage (UGS) project in Spain and the Ras El Besh oil prospect in Tunisia. To advance development of these projects, it was necessary to raise funds and early in the fourth quarter, Eurogas raised $32 million through a common share rights offering at $1.32 per share. I would like to thank the shareholders for their vote of confidence in the fundamental value of the Corporation's projects.

Castor UGS Project Advances on Several Fronts

Castor UGS is a large infrastructure project, estimated to cost approximately Cdn$800 million. Typically, such projects require long lead time for implementation, entailing: state planning acceptance; reservoir analysis; final engineering and design of facilities; environmental and regulatory approvals; and arrangement of project financing. The Corporation is focused on all the steps required to advance on these fronts.

It is clear that the Spanish Government recognizes that underground gas storage capacity is critical to the long-term stability of its gas distribution system and for strategic management of potential supply curtailments, as evidenced by the recent interruption of Russian gas supply. For Spain, the Castor UGS facility will account for 25 percent of the country's overall gas storage capacity and a very substantial 40 percent of daily deliverability from storage. Spain has recently approved an updated Energy Infrastructure Plan (Planificación de los Sectores de Electricidad y Gas), in which the Castor UGS project was granted the "A Urgent" category – meaning the project is unconditionally approved and vital to the Spanish gas system.

During 2005 Eurogas acquired, processed and finalized the interpretation of the 3D seismic over the Amposta structure. This data and the results of the 2005 Castor #1 development well were evaluated by an independent reservoir engineering company. The preliminary results estimate recoverable oil volumes on the western crest of the reservoir to be 5.5 to 10.8 million barrels. The final report will be available in the second quarter of 2006.

Also in 2005, the Corporation completed an Oil Production Study to evaluate options to produce the remaining oil. This information, together with data from the 2004 pre-Front End Engineering and Design (FEED) evaluation of gas storage facilities, has led to a point where the Corporation will soon commission the FEED study.

In August 2005 the Corporation commenced the environmental approval process for the Castor UGS project by filing a preliminary Environmental Summary Study covering both oil extraction and underground gas storage. In addition, following a consultative process with the authorities and as part of the regulatory roadmap, in January 2006 the Corporation filed a Development Application covering the complete Castor UGS project.

Following the successful drilling of the Castor #1 well in early 2005, Eurogas had announced its intention to invest in oil drilling and production facilities specifically designed to commence early oil extraction and therefore early cash flow. The

Letter to Shareholders

Head Office, Calgary
From left to right: Jim Batchelor, Vice President Exploration; Lynda Paananen, Controller; Jaffar Khan, President and Chief Executive Officer; Bruce Sherley, Executive Vice President and Chief Operating Officer; Andrew Constantinidis, Vice President and Chief Financial Officer

proviso was that plans were subject to the timing of environmental and regulatory approvals in conjunction with market availability and prices of rigs and oil production equipment. During the year, with the jump in oil prices, the market demand for the supply of rigs and equipment changed dramatically, with the result that suppliers are now demanding not only high rates, but equally important, long-term commitments. This has changed the financial balance between short-term cash flow and the lower cost of an integrated development.

As a consequence, the Corporation decided that it is not in a position to make material commitments for early oil production without first having in hand all of the requisite approvals for the overall UGS project. Under the current circumstances, the best strategy to ensure financial success of the Castor project is to conduct an integrated development process whereby rig contracts can be utilized for both oil production wells and for UGS gas wells. This will mitigate risk and significantly improve economics for the project as a whole. The integrated approach will mean deferring the oil production phase so that the crude oil will be produced through permanent facilities, which will also be used for the UGS phase. This will enable Eurogas to negotiate and obtain a complete financing package for the project, to perform remaining engineering work (including the FEED study), and to ensure that government regulatory permits and approvals have been issued for all stages before the Corporation proceeds with material contracts.

On the approvals front, Castor UGS is one of three UGS projects in Spain awaiting approval to proceed with development. The Corporation is actively engaged with the government to finalize aspects of the regulatory framework to back up existing legislation, so that a Development Concession can be granted as soon as possible.

Letter to Shareholders

Madrid Office
Front row, from left to right: Ramon Ortiz, Legal Counsel; Recaredo Del Potro, President and Chief Executive Officer, Escal UGS SL. Back Row, from left to right: Gaspar Martinez, Drilling Manager; Constantino Hidalgo Sr., Accountant; Constantino Hidalgo Jr., Accountant; Carlos Barat, Project Manager.

Environmental approval is a critical component in the applications process for the development of infrastructure projects, particularly those with offshore operations that involve numerous stakeholders – national, regional and local. Good progress has been made. The Ministry of Environment has been very supportive, and the lengthy statutory process is well underway. Recently the Corporation filed the full Environmental Impact Study with the authorities – a key milestone in the process. The next step will be the publication of a notice in the Official Gazette, whereby interested parties will be invited to inspect the relevant documents and to file comments, if any, within a 30-day period from the date of such notice.

Eurogas has been working with lending institutions to identify various options to finance the Castor UGS project. Current development costs are estimated at €510 (approximately Cdn$800 million), subject to refined estimates in the FEED study. This year the Corporation is accelerating the financing activity. In March 2006 Eurogas retained Dundee Securities Corporation as advisors to the Corporation and to evaluate financing options for the UGS project. Dundee has retained a senior financial specialist to pursue specific financing options for the UGS project. The Corporation intends to evaluate and finalize one or more of the financing options in the coming months, with a view to having a financial structure ready as early as possible.

Plans to Drill on Sfax Permit

In Tunisia the Sfax Offshore Permit, comprising approximately 1 million acres in which Eurogas holds a 45 percent working interest, contains several highly attractive exploration prospects and leads, including three previous oil discoveries with potential for development under current pricing. Plans are underway for the drilling of an appraisal well and development of one of these previously drilled discoveries.

Sfax is located on a hydrocarbon fairway that extends from Libya across the permit area to onshore Tunisia. Four known hydrocarbon systems are present in this trend and fields

Letter to Shareholders

adjacent to the permit have combined proved reserves in excess of 500 million barrels of crude oil and 2 trillion cubic feet of natural gas. Interpretation of the 2004 3D seismic program, which covered two of the three known oil accumulations, confirmed their potential and enabled the partners to select the first drilling location at Ras El Besh.

The operating partner is negotiating with a supplier to provide a suitable shallow-water drilling vessel, with the plan to drill Ras El Besh #3 in the third quarter of 2006. If successful, the well could be put on production by early 2007, with further drilling as required.

The Corporation has the needed financial resources to conduct its two major programs earmarked for 2006 and early 2007. Exiting Q1 2006 Eurogas has $20 million in cash and $6 million in available lines of credit. For 2006, $15 million has been assigned to Sfax. This is primarily for Eurogas' 45 percent share of drilling the Ras El Besh-3 exploration well and, after a successful completion of the well, the purchase of oil production facilities, with the goal to initiate commercial production.

Goals for 2006 and Beyond

The Corporation's mandate is very clear. The Castor Underground Natural Gas Storage project is a world-class project, conceived by Eurogas Corporation and systematically developed over a period of nine years. With the completion of the 2004/05 work program, which included reservoir simulation studies; a pre-FEED study; the reprocessing and interpretation of existing 3D seismic data; the drilling of the Castor #1 well; a new 138 sq. km 3D seismic program; and the submission of an environmental impact study, Castor is ready for full development. Eurogas will work through the regulatory process and organize the financial structure required to bring this long life asset to fruition.

For the Sfax Permit, Eurogas' goal is to establish early cash flow from the low-risk Ras El Besh prospect as quickly as the regulatory process and industry conditions permit, and to follow this with the exploitation of the Jawhara and Salloum structures, both of which have previously tested significant volumes of oil.

Acknowledgements

In closing, let me extend sincere thanks to our major shareholder, Dundee Corporation, for its continued, long-term support for the Eurogas business model of high-impact international energy projects. I also thank the Corporation's management and staff for their great work under challenging circumstances. And I thank Julio Poscente, the visionary who recognized and pursued all of the tremendous opportunities that Eurogas has been involved with to date, for his enthusiasm, and for his continued advice and guidance as Chairman of the Board.

On behalf of the Board of Directors,

M. Jaffar Khan
President and Chief Executive Officer
April 6, 2006

Castor Underground Natural Gas Storage Project

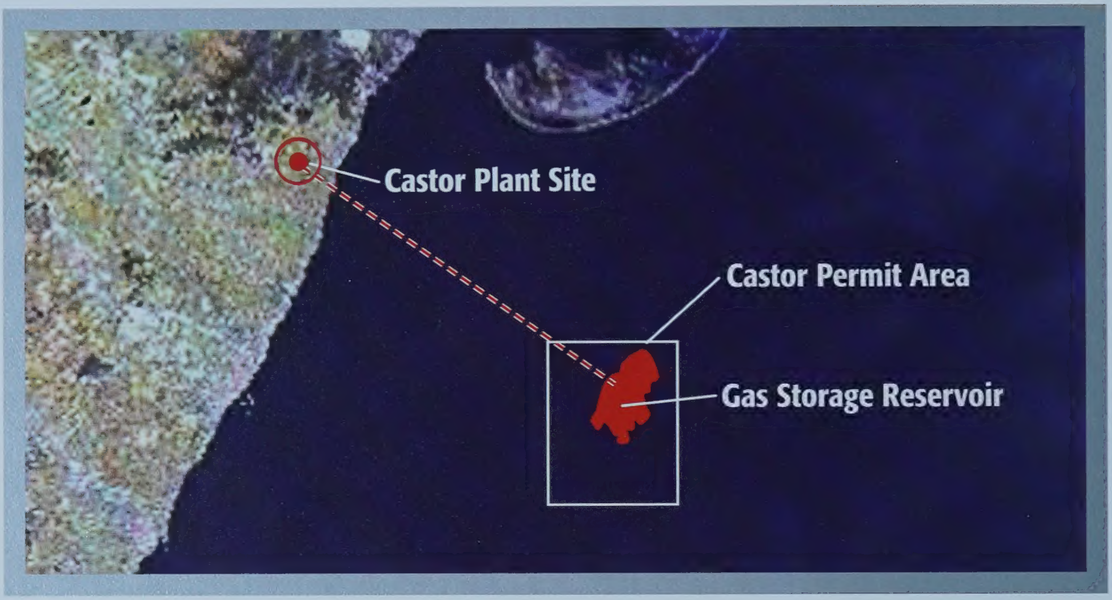
Introduction

The Castor Underground Gas Storage (UGS) project will fulfill an urgent need for additional natural gas storage in a rapidly growing and increasingly sophisticated national gas market. Natural gas consumption in Spain has grown at an average annual rate of 14 percent for 10 years, including 18 percent in 2005. During this same period, no new UGS facilities have been built.

Natural gas storage is an essential component of a mature natural gas infrastructure. Operational storage is required to accommodate cyclical fluctuations in natural gas demand and other operating activities; strategic storage is required to mitigate unplanned interruptions in natural gas supply. Castor's anticipated high delivery rate of 25 million cubic meters per day will contribute to strategic storage and reliability of supply to industrial and domestic customers, and could compensate for any supply shortfall equal to the capacity of the Maghreb pipeline or the Cartagena regasification plant for more than 50 days. Castor's anticipated significant working gas storage capacity of 1.3 billion cubic meters will provide a reserve for seasonal and peak demands.

The Castor UGS holds significant long-term value for Eurogas shareholders. The facility will account for 25 percent of the country's overall gas storage capacity and a very substantial 40 percent of daily deliverability from storage. Underground gas storage is a regulated activity in Spain. Revenue during the first 20 years includes both repayment of capital and return on capital, with the latter continuing afterwards at half the rate as long as the facility is operational. If the market for gas storage were to be fully liberalized, it would open the possibility of additional activities such as gas trading and other gas hub activities, thereby adding considerable value to the asset.

Castor Underground Natural Gas Storage Project



Project Description

The Castor UGS project entails the conversion of the abandoned Amposta oil field to a major natural gas storage facility. The project will include the production of remaining oil and the installation of gas storage facilities. The facilities will include an offshore platform and an onshore terminal, a subsea pipeline connecting the platform to the terminal, and a pipeline connecting the terminal to the Spanish national gas distribution network. The cost of the project is currently estimated to be Cdn$800 million. The final estimate will be determined by the Front End Engineering and Design (FEED) study, which is in progress.

The Amposta reservoir is located 21 kilometers off the eastern coast of Spain in the Mediterranean Sea south of the city of Barcelona. The proposed gas storage facility will be designed to use up to 16 wells, including eight to 12 deviated wells for gas injection and withdrawal, and up to four wells for disposal/observation. The dual-use wells will penetrate attics and sections of high porosity and permeability to maximize oil production and gas storage operations.

The offshore platform, which will be located in 60-meter-deep water, will have provision for the gas storage wells. Injection gas will be taken from the national gas network, compressed onshore and injected through the

Castor Underground Natural Gas Storage Project

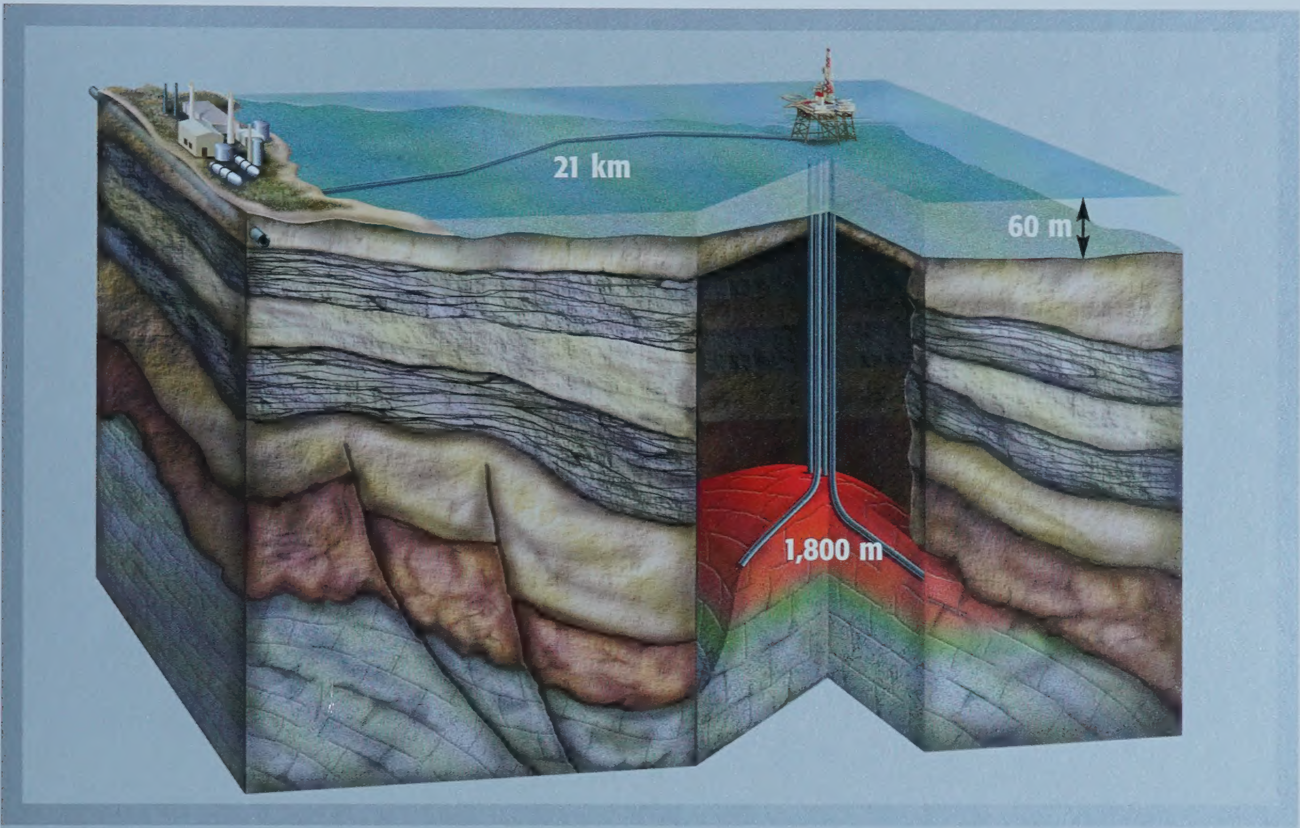


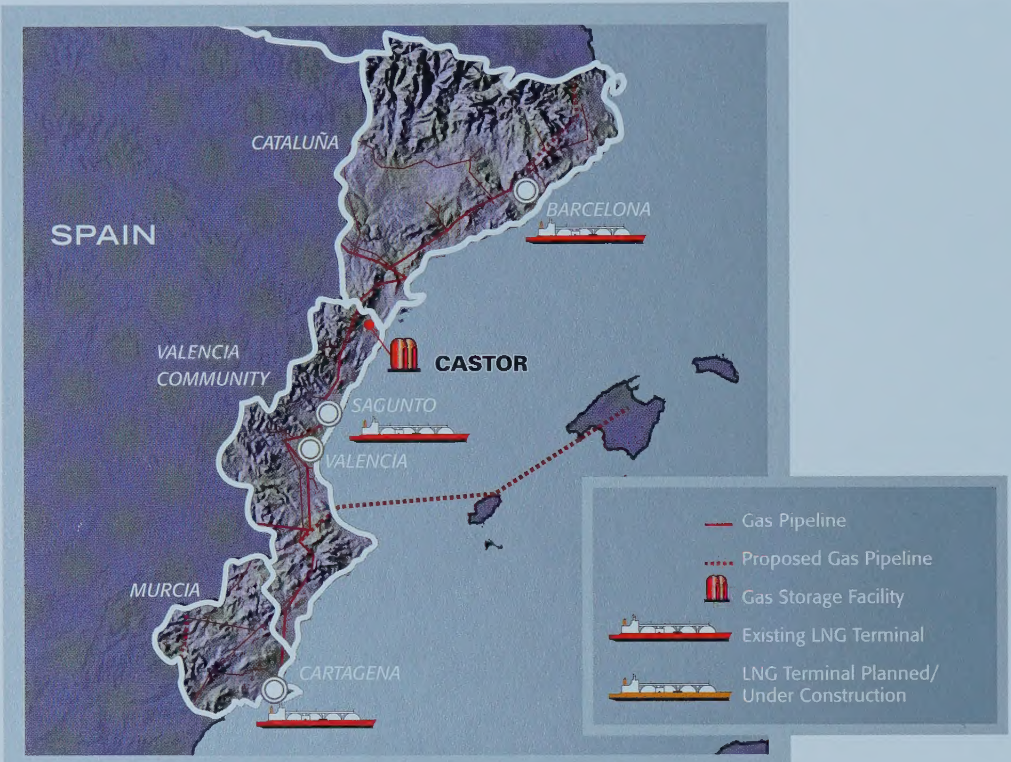
Illustration of the Castor project showing the Amposta reservoir, injection and withdrawal wells, the offshore platform connected by a subsea pipeline to onshore facilities, which are in turn connected to the national gas distribution system.

offshore pipeline directly into the wells. Withdrawn gas will be transported onshore for processing and re-injection into the national gas distribution network.

The onshore terminal will consist of two main components: a compression unit for gas injection and a treatment unit for gas withdrawal. An onshore pipeline supplied by the systems operator, Enagas, will connect the terminal to the Spanish national gas distribution network. Plant operations will be directly linked to the national operating system. Eurogas has purchased an eight-hectare property northwest of the town of Vinaròs to use for the onshore facilities.

Eurogas holds a 72 percent working interest in the UGS project and 100 percent working interest in the hydrocarbons that are produced from the permit.

Castor Underground Natural Gas Storage Project



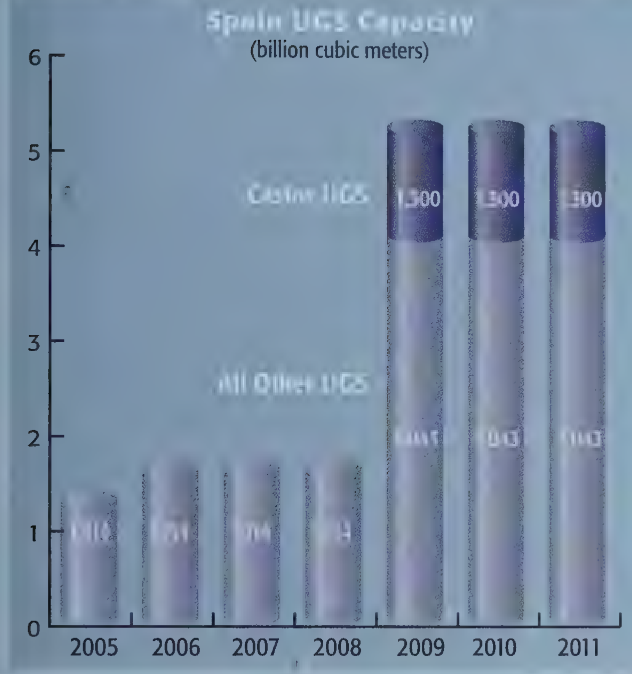
The Castor UGS market area of Cataluña, Valencia and Murcia accounts for 45 percent of Spain's total gas consumption, yet has no underground gas storage.

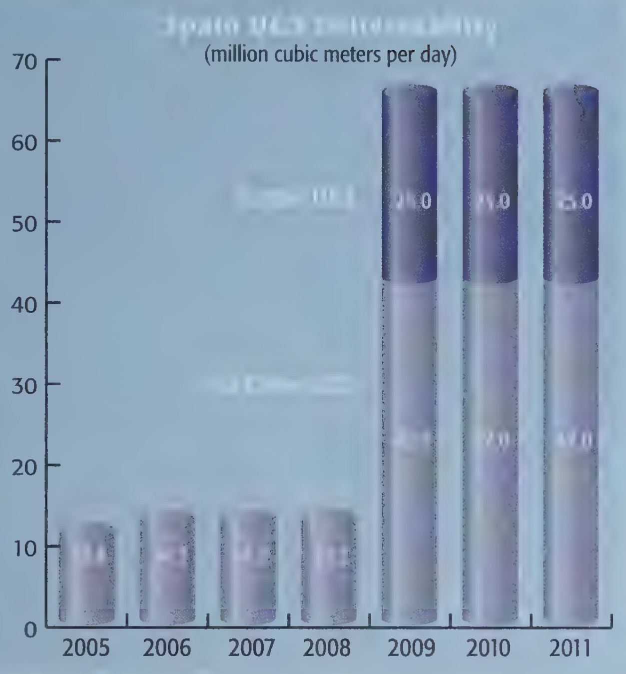
Gas Storage in Spain

Spain has an urgent requirement for large-volume, high deliverability natural gas storage capability. Spain's Hydrocarbon Law of 1998 and subsequent legislation recognizes the role of strategic storage in promoting a reliable natural gas system. Royal Decree 1716/2004 mandated that natural gas suppliers maintain strategic gas storage equal to 35 days' firm demand. The decree also stipulates that to be categorized as strategic storage the gas must be deliverable within 60 days. This requirement is not being met by existing storage facilities, which have low deliverability and may not be available for strategic purposes. Penalty provisions are in place for suppliers that fail to meet their obligation. While Spain currently has 1.4 billion cubic meters of underground storage in two facilities, their low deliverability reduces this volume to only 600 million cubic meters over a 60-day period.

The primary market area for the Castor UGS facility is the Mediterranean coastal regions of Cataluña, Valencia and Murcia. The combined demand for gas in this area is about 45 percent of the national total. The area contains three of the country's five Liqiuid Natural Gas (LNG) regasification plants: Barcelona, Cartagena and Sagunto, which together regasify 65 percent of Spain's LNG imports. At present,

Castor Underground Natural Gas Storage Project

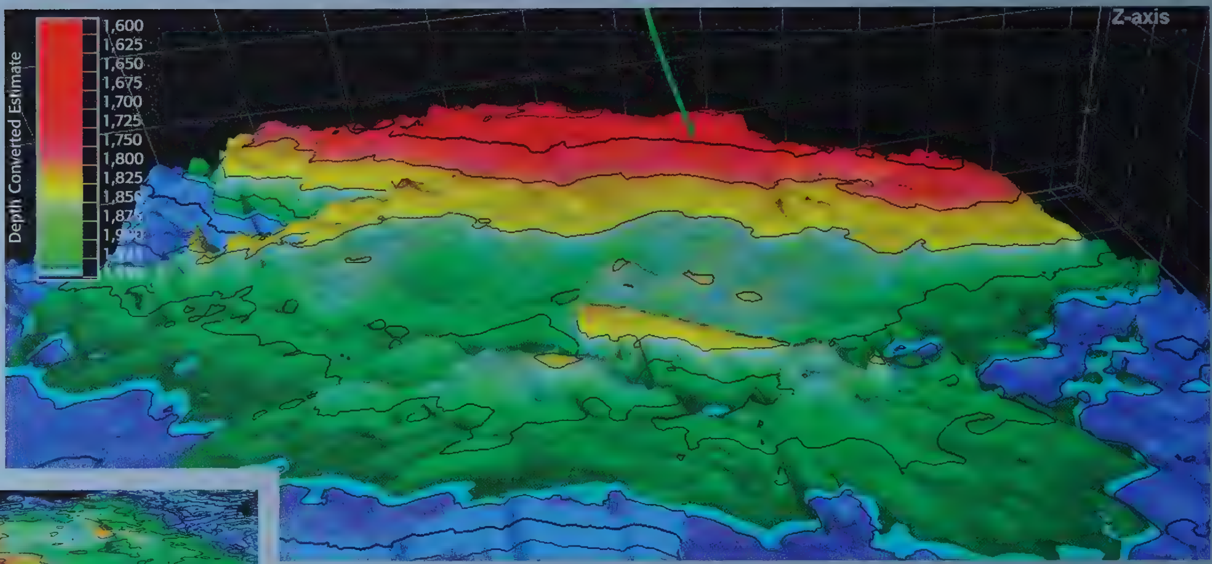


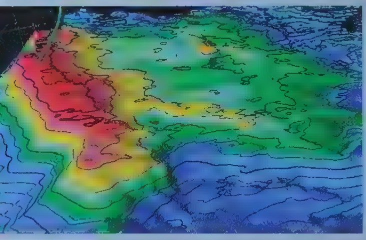


there are no underground storage facilities in the Castor market area, resulting in insufficient storage to even cover operational requirements. Castor will provide the needed operational storage, as well as capacity for strategic storage.

In order to support the continuing growth of gas consumption in Spain, significant investment in gas infrastructure is required. Because of its evident need, natural gas storage is a subject high on the agenda of regulators in Spain. The Castor storage facility can play a strategic role in ensuring reliable natural gas supply for Spain. Even with Castor, additional storage will still be needed to meet legislated requirements, likely by creating a national network of storage that will increase security of supply and facilitate continued growth in gas consumption.

Castor Underground Natural Gas Storage Project





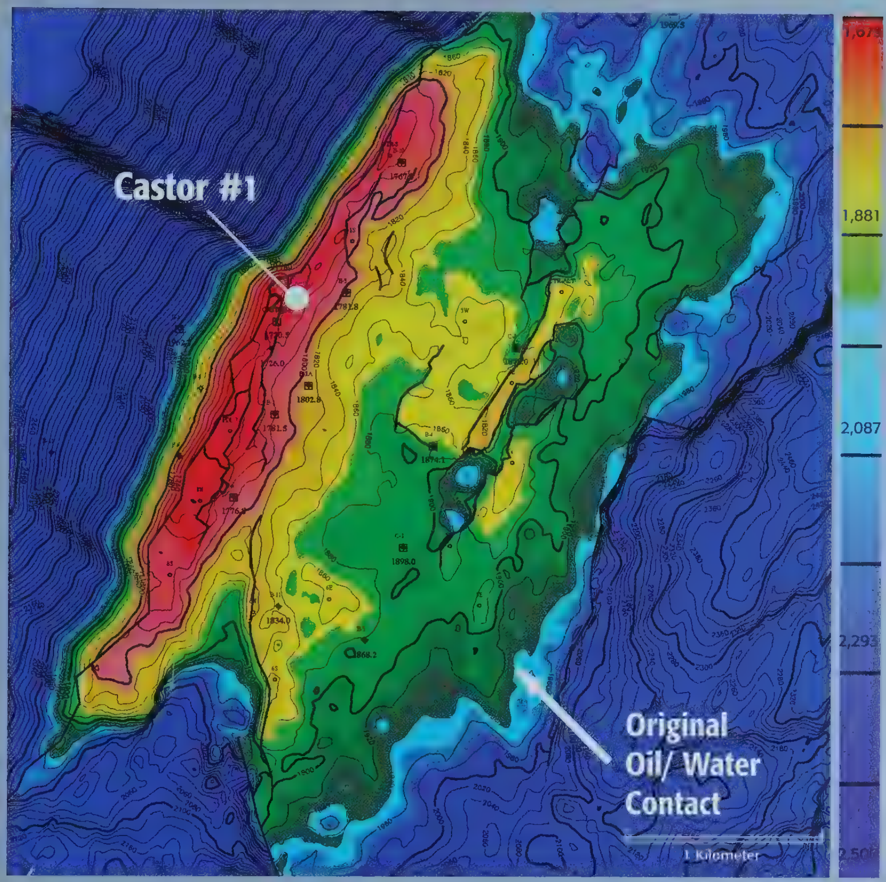
3D images of the reservoir based on the new seismic. Above: Amposta Reservoir viewed from the East. Left: Amposta Reservoir viewed from the South. The red area represents the Amposta Reservoir to a depth of 1,800 meters, the depth of the Castor #1 well, the yellow to 1,850 meters, and the green to 1,940 meters, the original oil water contact. The green vertical line represents the position of the Castor #1 well.

The Amposta Reservoir

The Amposta reservoir is technically well-suited for gas storage. The structure is a large, tilted fault block of highly porous Cretaceous-aged limestone lying at a depth of 1,700 meters below sea level. The reservoir is comprised of karstified limestone rock with extensive fracturing and brecciation that result in an average reservoir porosity of 11 percent and permeabilities in excess of 50 darcies. A key parameter for gas storage reservoirs is pressure, and the fluids in the Amposta reservoir are supported by a large, underlying aquifer that maintains near- constant bottom-hole pressure. The reservoir is sealed by 100 meters of tight shale and tight siltstones. The Amposta reservoir is a maximum of 250 meters thick, 5.0 kilometers long by 2.5 kilometers wide, and has sufficient capacity to hold 1.9 billion cubic meters of natural gas if filled to the level of the original oil/water contact.

The field was discovered by Shell Oil in 1970 and abandoned in 1989 after producing 56 million barrels of 17.5° API crude. Shell drilled 12 wells at Amposta starting in 1970. Six were productive, three were uneconomic due to low productivity, and three were abandoned after drilling off-structure. The six successful producers encountered limestone rocks that were porous and brecciated due to karstification that created vugs, caves and subsequent faulting and fracturing within the reservoir. The best producing wells tested oil at rates of 23,000 barrels per day, and the high quality of the reservoir allowed Shell to sustain average field production at 35,000 barrels of oil per day for the first two years of production.

Castor Underground Natural Gas Storage Project



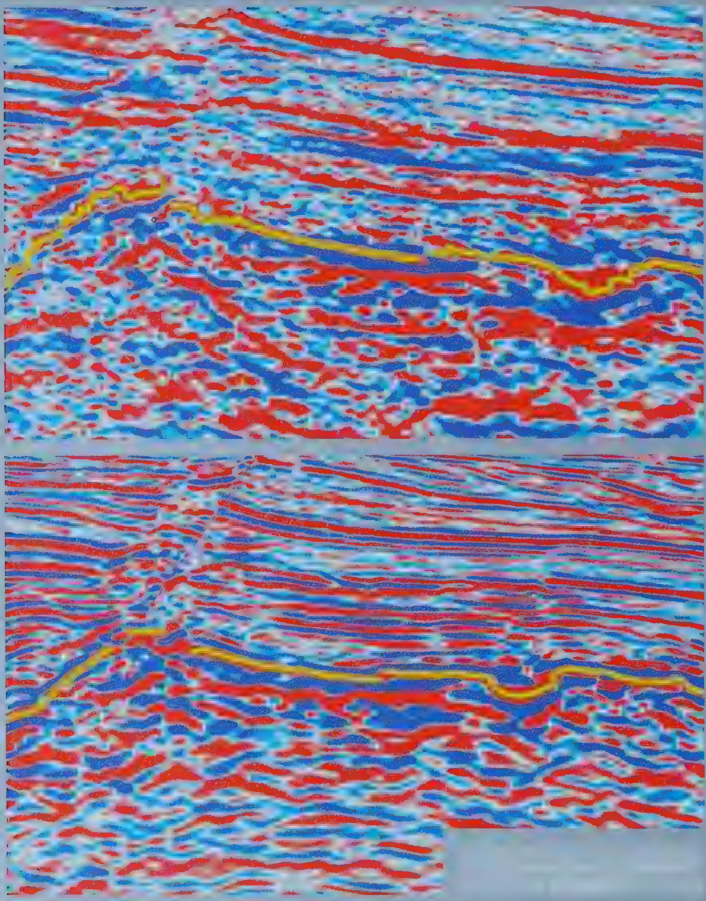
Map of the top of the Amposta reservoir based on new 3D seismic.

2005 Activities

Castor #1 Appraisal Well – The Corporation drilled the Castor #1 appraisal well in early 2005 to evaluate the quality of the Amposta reservoir and the competency of the overlying Castellon Formation to act as a seal for the gas storage reservoir.

Log and test data confirmed that the overlying strata are non-permeable and will act as an effective seal during gas storage operations. Castor #1 also confirmed the existence of undrained oil in reservoir attics that were not penetrated by Shell's wells. Petrophysical analyses and a drill-stem test of the producing formation confirmed the highly porous and permeable nature of the reservoir. During test operations the well flowed oil through a restricted choke at a maximum rate of 2,807 barrels per day with a bottom-hole pressure drop of only 3 psi, proving the formation has extremely high permeability and deliverability in excess of 10,000 barrels of oil per day. The well penetrated 98 meters of gross oil column (53 meters net) in the targeted Amposta reservoir without encountering the oil/water contact.

Castor Underground Natural Gas Storage Project



A comparison of the original Shell seismic (top) with the new Eurogas seismic (bottom) shows a significant improvement in quality and detail.

Seismic Program – In early 2005 the Corporation commissioned a new 3D seismic program over the Amposta reservoir. A comparison of the original 3D seismic shot by Shell in 1983 with the Corporation's newly acquired 3D seismic shows a significant improvement in the quality and detail of the mapping of the structure. Analysis of the 138 sq. km program has provided a more accurate map of the surface features of the reservoir and the ability to identify the location of structural highs. Improved resolution of internal features of the structure has enabled the mapping of zones of high porosity and will lead to precisely defined locations for the drilling of gas storage wells.

In 2003 GLJ Petroleum Consultants Ltd. (GLJ), independent reservoir engineering consultants, constructed a simulation model of the Amposta reservoir based on Shell's wells and the 1983 3D seismic. New data from the Castor #1 well and the 2005 3D seismic program provide the Corporation with an improved set of data, which will be integrated with the Shell data to construct a more sophisticated and detailed reservoir model. This model will be used to refine reservoir parameters such as the working gas and cushion gas volumes, the deliverability and number of gas wells and water coning tolerances. It will also be used to more accurately estimate the volume of oil remaining in the reservoir and the rate at which it can be withdrawn.

Recoverable Oil

In late 2005 the Corporation engaged DeGolyer and MacNaughton Canada Ltd., an independent petroleum engineering firm, to incorporate the results of the Castor #1 well and the 2005 3D seismic into a new study of the reservoir. While the study confirmed the presence of commercial volumes of undrained oil, the reporting of "reserves" by a Canadian public company must be compliant with National Instrument 51-101 which requires all regulatory approvals to be in place before "reserves" can be assigned. The Corporation has submitted the required development applications to the regulatory authorities and expects approval during the second half of 2006.

DeGolyer and MacNaughton's estimate of original-oil-in-place of 140 million barrels is 40 percent higher than the initial Shell estimate. Recoverable oil in the western crest of the reservoir to the depth reached by the Castor #1

Castor Underground Natural Gas Storage Project

of the reservoir was estimated to be 5.5 million barrels. The analysis indicated there is probably a total of 10.8 million barrels, which would imply an additional 50 meters of oil-bearing reservoir below the Castor #1 well. This result is within the range estimated by GLJ in 2003. Additional oil may be contained in the eastern attics, though the 2005 seismic has shown them to be smaller than originally estimated. Market research indicates that Castor heavy crude oil will be priced in the range of 35 to 45 percent discount to Brent, depending upon a number of factors, including refinery capacity.

Regulatory Process

To be accepted and recognized for remuneration within Spain's natural gas system, a project must be approved in the Spanish government's Electricity and Gas Infrastructure Plan. (Planificación de los Sectores de Electricidad y Gas). The Castor project was first recognized in the 2002 Plan, receiving a "C" rating. This acknowledged the merits of the project, but classified it as not ready for approval and construction. On March 31, 2006, Spain's Council of Ministers approved the latest revision of the Infrastructure Plan (Revisión 2005 – 2011) in which Castor UGS received an "A Urgent" rating, the highest category available. Category "A" means the project has been unconditionally approved and "Urgent" means that the project is essential to maintain the integrity of the gas system or to meet rising gas demand. This is an essential milestone in the overall regulatory approval process.

To commence construction of the project, the Corporation requires the granting of a Development Concession from Spain's Department of Energy. Eurogas submitted the application for this concession, which included both the oil and gas phases of the project, in January 2006. The Corporation is actively engaged with the government to finalize aspects of the regulatory framework to support existing legislation, so that a Development Concession can be granted as soon as possible. The government is currently engaged in the final technical and financial review of the project. Eurogas plans to await receipt of this approval before committing to major contracts or expenditures.

Environmental approval from the Ministry of the Environment is required before the granting of the Development Concession. Eurogas began this process in early 2005 and submitted the Environmental Summary in August 2005. The Ministry then disseminated the information to 50 stakeholders, including non-governmental environmental protection organizations, for comments and questions. The Corporation addressed these issues in a detailed Environmental Impact Study, which was submitted in March 2006. The next step is for the Ministry to make the project information available for 30 days for public review. The final step is the preparation by the Ministry of the Environmental Impact Statement, which once issued, will allow the formal approval of the Castor UGS project's Development Concession.

2006 Development Program

Engineering and Facilities – The most important item on this year's agenda is the FEED study. This is the set of key engineering documents that serve as a blueprint for the entire development process, including design, specifications, detailed cost estimates and project scheduling. The 2003 GLJ reservoir model showed that gas storage operations would be enhanced by the removal of oil, therefore Eurogas plans an integrated development program whereby oil will be removed prior to gas storage operations. The FEED study is a crucial building block in the UGS development and is a prerequisite for the Company to select and appoint an engineering, procurement and construction (EPC) contractor, and for project financing. The FEED study is a major undertaking, with an expected cost of $4-6 million and an expected completion date of early 2007.

Regulatory Process – During 2006 Eurogas anticipates receiving two key regulatory approvals: the Development Concession from Spain's Department of Energy and the Environmental Impact Statement from the Ministry of the Environment.

Castor Underground Natural Gas Storage Project

Financing – Designing and obtaining a suitable financing package covering the entire Castor project, one that will help to advance the project to completion expeditiously while creating maximum value for Eurogas' shareholders, is a major priority for the current year. In Q1 2006 the Corporation retained Dundee Securities Corporation with a mandate to seek suitable sources of financing and to assemble a financial package. A number of financial institutions have expressed interest in financing the project. Eurogas intends to study the options in the coming months, with a view to having a financial structure finalized as soon as possible.

Remuneration

As a recognized component of Spain's natural gas infrastructure, Castor would operate as a regulated utility and is not expected to be subject to commodity price risk or market-based gas trading risk. The Spanish government has issued a standard remuneration structure for similar projects, but major participants in the Spanish natural gas industry are attempting to improve regulated returns. A positive outcome would benefit the Castor project.

The remuneration regime for underground natural gas storage contains three components: *Return of Capital, Return on Capital* and *Payment for Operating Costs.*

Return of Capital = Value of Investment ÷ Life of Asset. The Value of Investment is based on actual audited costs, and is increased annually by 75 percent of the Inflation Rate. Included in the cost are investments carried out up to five years prior to the date on which the Development Concession is granted. The regulations set the Life of Asset for underground storage at 20 years.

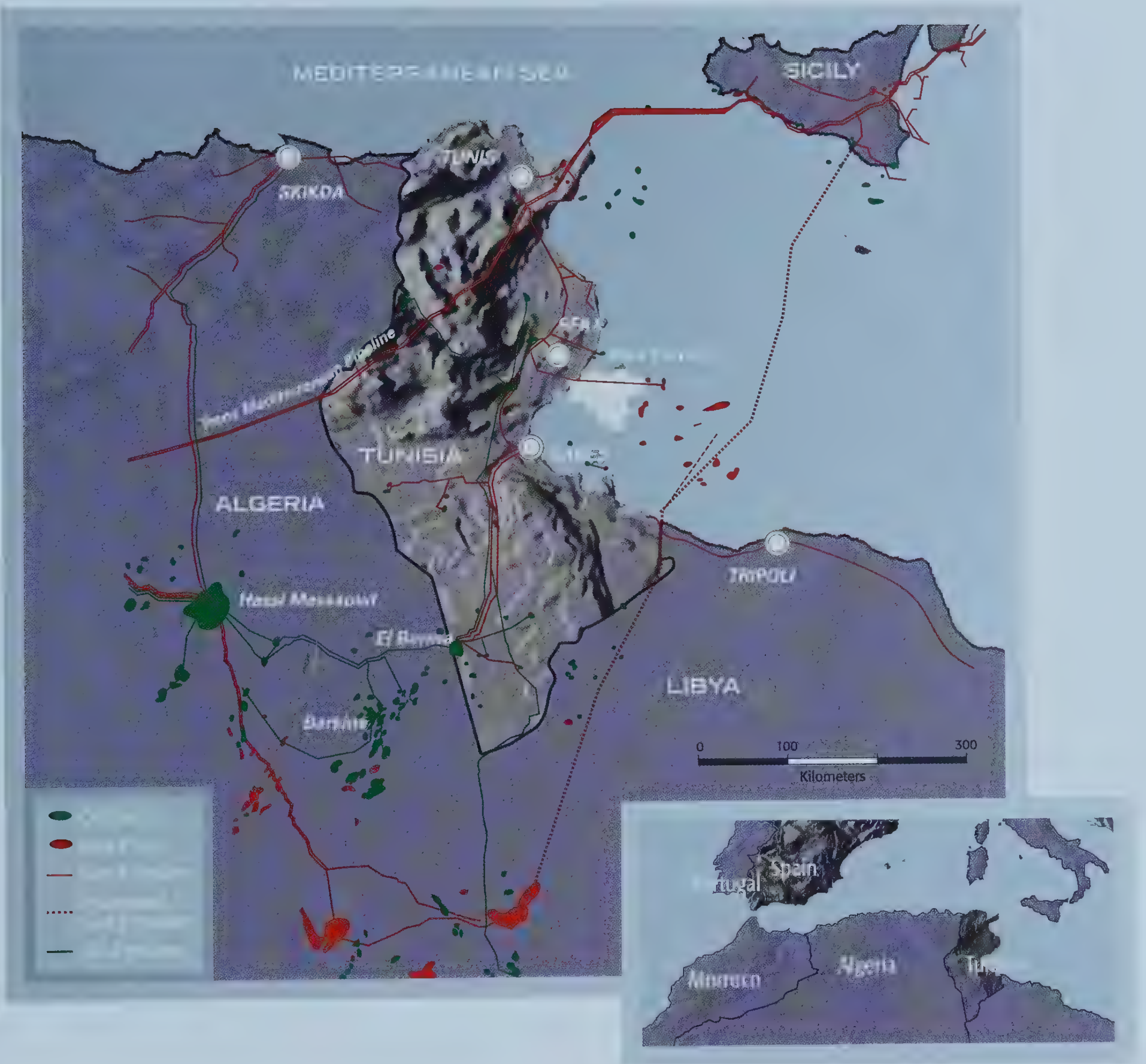
Return on Capital = Value of Investment x Rate of Return. The Rate of Return is defined as the annual average of 10-year government bonds plus 1.5 percent. This rate is set in January for each year. For 2006 the rate is 3.51 percent + 1.5 percent = 5.01 percent. At the end of the facility's regulated life (20 years for Castor) there is a reduction in the Return on Capital to 50 percent of what it would otherwise be.

Payment for Operating Costs = Last Year's Payment x (1 + Inflation Rate x Efficiency Index). The Payment for Operating Costs for new facilities is determined in the authorization process. In the following years, the payment for operating cost is increased by 85 percent of the Inflation Rate.

The Inflation Rate is the average of the change in the consumer price index and the industrial price index. The change in the Spanish consumer price index has averaged 2.9 percent over the past decade, which on average has been 1.1 percent higher than the Eurozone average. The change in the Spanish producer price index has averaged 1.8 percent over the past decade. For 2006 the Inflation Rate is set at 2.41 percent.

A Provisional Economic Regime may be agreed on for the period between the granting of the Development Concession and final project start-up, provided this period does not exceed three years. Investments and some operating costs can be included. The inclusion of a Provisional Economic Regime will provide cash flow during the construction phase.

Tunisia



Eurogas has been active in Tunisia since 1995, and has developed strong relationships with the authorities and extensive knowledge of Tunisian exploration opportunities. During 2005, Eurogas converted the offshore Sfax Seismic Option to an Exploration Permit and relinquished the onshore El Hamra Exploration Permit.

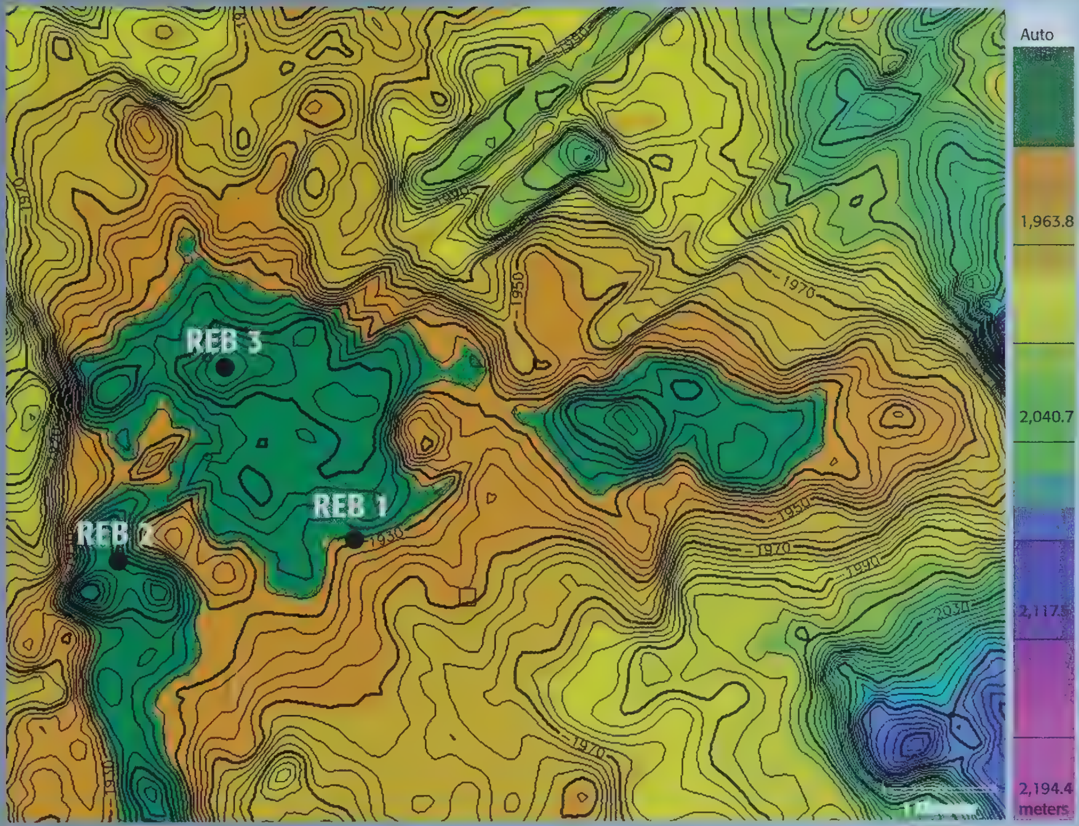
Tunisia

The Sfax Permit

The offshore Sfax permit, comprising some one million acres, is located within a prolific hydrocarbon fairway extending from Libya across the Corporation's permit area to onshore Tunisia. The permit contains four known hydrocarbon systems which are limestone and dolomite formations at depths of 1,800 to 2,500 meters. Fields adjacent to the permit have combined proved reserves in excess of 500 million barrels of crude oil and 2 trillion cubic feet of natural gas. The permit, in which Eurogas holds a 45 percent working interest, contains several highly attractive exploration prospects and leads, including three previous oil discoveries that are targeted for development. Sfax thus shows every sign of being a highly prospective, multi-year exploration and development project with a succession of prospects.

Eurogas acquired the permit in 2004 after assessing the three structures drilled by previous operators that tested oil at rates up to 1,800 barrels per day, and identifying a further 18 undrilled geological structures. An evaluation of the existing seismic and the new 3D seismic acquired in 2004 identified the exciting potential of the permit. Eurogas and its operating partner converted the Seismic Option to a four-year Exploration Permit in December 2005 with a commitment to drill one well.

Tunisia

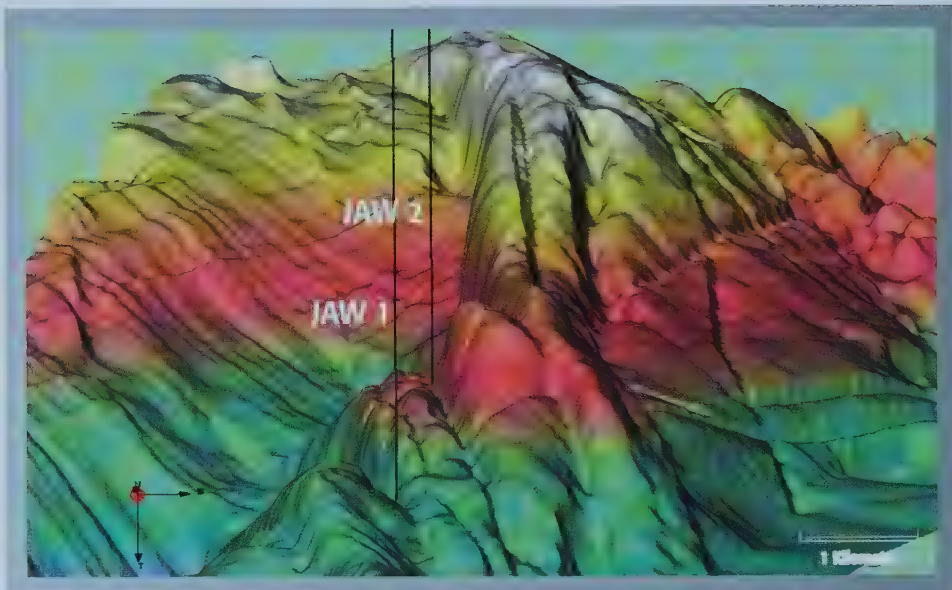


Map of the top of the Ras El Besh structure. REB 1 and REB 2 were previously drilled with REB 2 testing oil at over 600 barrels per day. REB 3 is Eurogas' proposed drill location.

Plans are well underway to drill the commitment well in the third quarter of 2006 on the Ras El Besh structure, one of the previously drilled discoveries. Interpretation of the 2004 3D seismic program, which covered two of the three known oil accumulations, confirmed their potential and enabled the partners to select the first drilling location.

Joint-venture partners in the Sfax Permit are remunerated under the terms of a production sharing agreement whereby revenues vary with payout of capital expenditures and production rates. Royalties and taxes are paid out of the government's share of production.

Tunisia



Vertically exagerated 3D image of the Jawhara structure, JAW 1 and JAW 2 were previously drilled with JAW 1 testing oil at over 1,200 barrels per day.

2005 Activities – Activity during the year focused on the interpretation of the 348 sq. km 3D seismic survey acquired in 2004 over two of the structures that previously tested oil. Interpretation to date confirms the Ras El Besh structure has the potential to hold economic volumes of recoverable oil, and further work is underway to delineate the Jawhara structure. The seismic also identified untested, closed structures and other sizeable structures that extend out of the surveyed area.

Development Strategy – Eurogas' strategy for Sfax is to drill and if successful bring on-stream the Ras El Besh prospect. Though the anticipated oil volume is not as large as many of the other structures, Ras El Besh is seen as a low-risk prospect that can provide early cash flow. This will be followed by exploration drilling for larger prospects. An industry major drilled two exploration wells on the Ras El Besh structure in the 1990s using a 2 kilometer-wide seismic grid. The second well included a drill-stem test that flowed at a rate of 612 barrels per day of light oil. The well was abandoned due to a combination of low oil prices and a reserves base deemed too small for a major company to develop.

Tunisia

Eurogas geo-scientists Dave Klepacki and Scott Mitchell work on seismic interpretation.

The 2004 3D seismic data provided a clearer image of the reservoir. It has enabled placement of the planned obligation well (REB-3) in a location that is 40 meters structurally higher than REB-1. Drilling success at Ras El Besh could provide cash flow to drill a second well on the Jawhara prospect. The Jawhara structure was discovered by a major company in the early 1970s with the drilling of two exploration wells. JAW-1 tested clean oil at 1,200 barrels per day and JAW-2 drilled off-structure and was abandoned. Seismic imaging was challenging at that time and the new 3D seismic illustrates how the wells penetrated the producing horizon in flank and faulted positions off the main structure.

2006 Planned Activities – Negotiations have commenced with the owner of a shallow-water rig, which could lead to drilling the REB-3 development well in the third quarter of 2006. Eurogas will update investors as further information becomes available.

Eurogas considers Ras El Besh to be a low-risk prospect as REB-2 tested light oil at 612 barrels per day. The risks relate to faulting and reservoir rock quality, which determine productivity and reserves potential. The operator-partner estimates recoverable oil volumes in the range of 6 to 15 million barrels. The low case exceeds the economic threshold, generating positive cash flow and providing technical information for further drilling if merited.

Management's Discussion and Analysis

This Management's Discussion and Analysis ("MD&A") provides a discussion and analysis of financial condition and results of the operations of Eurogas Corporation ("Eurogas" or the "Corporation") for the year ended December 31, 2005. The following information has been prepared by management and should be read in conjunction with the audited consolidated financial statements for the years ended December 31, 2005 and 2004, together with the accompanying notes. This MD&A is based on information available as of April 17, 2006. The reporting and the measurement currency is the Canadian dollar.

Eurogas is a Canadian-based company whose common shares are traded on the TSX Venture Exchange (TSXV). During the period, Eurogas carried on exploration and development activities in Spain and Tunisia. Eurogas is focused on creating long-term value through the development of high-impact energy projects. The Corporation is developing an underground natural gas storage facility in Spain and is conducting exploration programs for oil and natural gas offshore Tunisia.

Forward-looking statements

This MD&A contains forward-looking statements. Forward-looking statements are based upon assumptions and judgments with respect to the future including, but not limited to, the outlook for commodity and capital markets, as well as the regulatory and legal environment. These factors may be difficult to predict. As a result, forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those anticipated.

All financial units in this MD&A are expressed in Canadian dollars unless otherwise stated.

2005 highlights

The Corporation successfully raised $32.1 million ($31.4 million net of issue costs) through a Rights Offering which closed on October 21, 2005. The fully subscribed share issue allowed shareholders to subscribe to 24,348,286 common shares at $1.32 per common share. Proceeds from the offering are being used to advance development of the Corporation's Castor UGS Project, a significant underground gas storage project in Spain, as well as exploration prospects in Tunisia.

During 2005, Eurogas accelerated its drive towards full development of the underground gas storage project including:

- Two major milestones were successfully achieved: the Castor #1 development well program was completed through investment of $10.5 million (2004 – $3.9 million) during the year and a state-of-the-art 138 sq. km. 3D seismic program was conducted at a cost of $2.27 million (2004 – $114,000). Preliminary estimates of recoverable oil based on the data and results from the 2004/05 seismic and development well programs, suggest recoverable oil volumes on the western crest are 5.5 to 10.8 million barrels. The new reservoir report is expected to be available in June 2006.
- The Corporation commenced the environmental approval process for the Castor UGS Project and in August 2005 submitted an environmental application.

Management's Discussion and Analysis

- A total of $2.1 million was invested during the second half of the year on strategic engineering and design activities related to the on - and offshore gas storage facilities for the Castor UGS Project.
- Subsequent to the end of the year, the Castor UGS Project received its first regulatory approval with the granting of an "A Urgent" rating, the highest category available, in the latest update to the Spanish Electricity and Gas Infrastructure Plan.

In Tunisia, the Corporation invested $1.1 million (2004 – $0.7 million) on its offshore Sfax permit. Eurogas holds a 45 percent interest in the permit on which processing and interpretation of a 348 sq. km 3D seismic program was completed during the year. Mapping of this 3D data confirms the existence of the Ras El Besh and Jawhara structures, as well as several other large structures.

During the year, the Corporation and its joint-interest partner successfully converted the Sfax Prospecting Permit to an Exploration Permit. The four-year permit (commencing December 9, 2005) includes a commitment to drill one exploration well at a budgeted cost of $7.7 million to Eurogas.

International oil and gas operations

During 2005, Eurogas successfully completed a number of critical phases in the development of its high-impact energy projects.

Spain

The Corporation's Castor UGS Project entails the conversion of the abandoned Amposta oil field (located 21 kilometers off the eastern Mediterranean coast of Spain) to natural gas storage operations. Capital investment on the project totalled $16.5 million during the year (2004 – $5.3 million). Eurogas holds a 72.0 percent working interest in the Castor gas storage project and 100 percent interest in all hydrocarbons produced on the permit.

Eurogas accelerated its drive towards full development of the Castor UGS Project through the completion of its 138 sq. km. 3D seismic program, which was shot in early 2005. During the year $2.27 million (2004 – $114,000) was invested in the seismic program. This seismic program will be used to optimally locate wells to maximize the volume of oil recovery and to allow for maximum efficiency of gas storage operations in the Amposta structure.

During 2005, Eurogas completed drilling and testing operations on the Castor #1 well, which is situated at the crest of the Amposta reservoir, for total expenditures of $10.5 million (2004 – $3.9 million), then temporarily suspended the well following testing. Authorization for the production of oil is required from the applicable authorities. Upon receipt of approval, the Corporation intends to re-enter the well and commence production, followed by the drilling of additional wells.

During the third quarter of the year, the Corporation filed an application for environmental approval of the Castor UGS Project including oil evacuation, a 20-kilometer-long pipeline and offshore/onshore gas storage facilities.

Management's Discussion and Analysis

In January 2006, the Corporation submitted a development concession application to Spain's Ministry of Energy.

The 2006 capital budget for Spain includes $6.4 million for the Front End Engineering and Design (FEED) study and other technical and engineering studies. Depending on the timing of regulatory approvals, additional capital may be required to begin development of the UGS and oil production facilities.

For reasons of conformity, the Corporation has reverted the name of the underground gas storage project from "Amposta" to "Castor".

Minority Unit Holders
The Corporation is the majority unit holder and operating partner for the entity responsible for development of the underground gas storage facility. During the third quarter, minority unit holders contributed capital totalling $1.3 million to the development of the project. The Corporation's capital assets increased and the minority unit holders' interest increased on a pro-rata basis as a result of the contribution. The capital contribution occurred concurrently with a cash call obligation that was fulfilled during the third quarter.

Tunisia
Eurogas is conducting exploration programs for oil and natural gas in Tunisia.

Sfax Permit
The Corporation's 1.0-million-acre Sfax Permit is located in shallow Mediterranean waters off Tunisia's east coast in the Gulf of Gabes. Eurogas holds a 45 percent working interest and is a non-operating partner in the permit. During the year, the Corporation invested $1.1 million (2004 – $0.7 million) on the processing and interpretation phase of a 348 sq. km 3D seismic program conducted over the permit area in 2004. This program encompassed two wells that previously tested oil from separate structures at rates of 1,208 and 612 barrels per day. Mapping of this 3D data confirms the existence of the Ras El Besh and Jawhara structures, as well as several other large structures.

In July 2005, the Corporation applied to the government to convert the Sfax Seismic Prospecting Permit to an Exploration Permit. The Exploration Permit was granted for a period of four years commencing December 9, 2005 with a work commitment to reprocess 250 km of existing 3D seismic data, and to drill one exploration well.

El Hamra Permit
Effective July 22, 2005, Eurogas relinquished its 20 percent interest in the 1.2-million-acre El Hamra Permit located onshore in southern Tunisia. Eurogas invested $271,674 year-to-date (2004 – $165,915) representing its share of total costs in accordance with a farmout agreement established during the third quarter of 2004. As part of the agreement, the farmee made an up-front payment of US$500,000 and agreed to fund the Corporation's portion of costs related to the drilling of the EH-1 well to a total cost of US$5,000,000 over which the Corporation was

Management's Discussion and Analysis

responsible for its 20 percent share. The EH-1 well was drilled, tested and abandoned during the second quarter of 2005.

In both Spain and Tunisia the current tight market for oil exploration and production equipment may have further impact on the cost and timing of planned activities.

Exit from Canadian oil and natural gas operations

Carve-Out of Canadian Assets

In 2004, the Board of Directors reorganized the Corporation through the separation of the Canadian assets and operations and the foreign assets and operations into two separate public companies. The Board of Directors and management of the Corporation believed that the reorganization would serve to enhance shareholder value by allowing the Corporation's management to focus on realizing the full value of the Corporation's unique projects in Spain and Tunisia. Pursuant to the plan of arrangement, each shareholder of the Corporation received one new Eurogas common share and 0.2 of a Great Plains Exploration Inc. ("Great Plains") common share for each Eurogas common share held.

Operating results for the years ended December 31, 2004 discussed throughout this MD&A have been restated to reflect assets and operations related to the carve-out to Great Plains as a component of discontinued operations.

Sale of Remaining Canadian Producing Assets

On May 1, 2005 the Corporation sold its remaining Canadian interests in two minor, non-operated properties, which were retained for a period of time following the carve-out of assets to Great Plains, to a third party for cash proceeds of $650,000.

As a result of this transaction, Eurogas has presented all of the revenues and expenses associated with the operations included in the sale as a component of discontinued operations for financial reporting purposes. The book value of assets and liabilities associated with discontinued operations has been netted against proceeds received on the sale.

As a result of the sale of the Canadian producing assets, this MD&A has been segregated between continuing operations (primarily Spain and Tunisian projects) and discontinued operations (Canada). Any prior year's comparative figures have been restated to give a meaningful comparison of the current period's activities.

Management's Discussion and Analysis

Selected financial information for the operations included in discontinued operations is reported below:

(000s)	2005	2004
Revenues, net of royalties	$ 177	$ 4,094
Earnings (loss) from discontinued operations related to carve-out, before taxes	$ (41)	$ 759
Earnings from discontinued operations related to Canadian assets sold in 2005, before taxes	30	610
Pre-tax gain on sale of assets	396	–
Provision for income taxes(1)	(90)	(446)
Earnings from discontinued operations	$ 295	$ 923

(1) *The 2005 provision for income taxes related to discontinued operations includes a refund receivable of $178,208 from Alberta Treasury in respect of the Corporation's 2004 Alberta Income Tax Return.*

General & administrative (G&A) expenses

The Corporation incurred G&A expenses of $2.2 million in 2005 compared to $704,412 for the same period in 2004. G&A expenses as reported have increased from 2004, primarily as a result of a change in the nature of the Corporation's business activities. As part of the restructuring in 2004, administrative costs associated with the carved-out business activity were allocated to Great Plains. Senior management remained with Eurogas subsequent to the carve-out and the business focus and strategy changed.

The increase in G&A expense is also due to the increase in stock-based compensation expense incurred. Stock-based compensation amounts expensed in association with the Corporation's stock compensation plan was $573,584 for 2005 compared to $65,002 expensed during 2004. The Corporation's stock option plan provides for the granting of stock options to employees, directors, and consultants which vest over a three-year period. Amortization of the fair value of the stock options is accounted for as a non-cash charge.

The Corporation allocated $741,000 of G&A expenditures incurred during the year (2004 – $624,100) to its subsidiaries. These costs were capitalized to respective international asset pools in association with the pre-production phase of each location.

Depreciation

Year-to-date, depreciation of the Corporation's furniture and fixtures increased to $88,051 from $24,508 for the same period in 2004.

Management's Discussion and Analysis

Income taxes

During the year, the Corporation recognized a provision for future income tax expense totalling $36,800 related to continuing operations, compared to $22,120 in 2004.

A current income tax recovery of $192,448 was recognised during the year related to continuing operations compared to $95,000 in 2004.

Net earnings (loss)

Net loss increased to $1.8 million in 2005, from $189,292 in 2004. The Corporation's exit from Canadian oil and natural gas operations during 2005 resulted in a significant decrease in revenues from 2004.

As at the end of 2005, Eurogas no longer held an interest in producing properties.

Per share information

Basic earnings (loss) per common share are computed by dividing the net earnings (loss) available to common shareholders by the weighted average number of common shares outstanding during the year. For the year ended December 31, 2005 the weighted average common shares outstanding were 102,178,742 (2004 – 76,244,832). Diluted amounts per common share are calculated using the treasury stock method to determine the dilutive effect of stock options. The treasury stock method assumes that the proceeds received from the exercise of "in-the-money" stock options are used to repurchase common shares at the average market price during the period. The diluted weighted average common shares for the year ended December 31, 2005 were 104,531,550 (2004 – 79,651,297).

Liquidity and capital resources

Eurogas holds a revolving credit facility with Dundee Corporation ("Dundee"), the Corporation's principal shareholder, to a maximum of $6 million, bearing interest at the rate of prime plus 2 percent per annum, and a standby rate of 1 percent per annum on any undrawn portion of the facility. As at December 31, 2005, $100,000 was outstanding on the facility.

Working capital of $24.7 million as at December 31, 2005 has increased from $10.2 million as at December 31, 2004, primarily due to proceeds received from the closing of a rights offering in October 2005. Included in working capital at December 31, 2005 is cash totalling $26.2 million.

On October 21, 2005, Eurogas closed a rights offering to shareholders to subscribe to 24,348,286 common shares at a subscription price of $1.32 per share. The offering was fully subscribed raising a total of $32,139,738 ($31,427,529 net of costs related to the offering).

Management's Discussion and Analysis

On December 31, 2004, Eurogas closed a rights offering to shareholders to subscribe to 19,370,778 common shares at a subscription price of $0.39 per share. The share issue was fully subscribed, raising gross proceeds of $7,554,368 ($7,282,209 net of costs related to the offering).

At December 31, 2005, the Corporation's market value of common shares was $157.5 million based on the closing price of $1.29 per share and 122,066,430 shares outstanding. During the year, Eurogas issued 866,667 shares through the exercise of options (2004 – 1,550,000). The number of common shares outstanding at April 17, 2006 was 123,241,430.

Related-party transactions

Certain transactions with Dundee occurred during the year including interest and standby fee payments totalling $214,156 (2004 – $nil) related to the Corporation's $6 million credit facility established during the second quarter of 2005. Cash interest payments are due monthly in arrears.

In addition, the Corporation paid $62,323 during the first quarter and $129,254 during the fourth quarter of 2005 to an affiliate of Dundee for services provided as Managing Dealer of the Corporation's two Rights Offerings which closed on December 31, 2004 and October 21, 2005, respectively.

Business risks

There are a number of inherent risks associated with oil and natural gas operations and development. Many of these risks are beyond the control of management. The following outlines some of the Corporation's principal risks and their potential impact.

All of the Corporation's oil and natural gas operations and related assets are located outside Canada, and are subject to special risks inherent in doing business in a number of international locations. These risks can involve matters arising out of the policies of foreign governments, imposition of special taxes or similar charges by government bodies, foreign exchange fluctuations and controls, access to capital markets, civil disturbances and deprivation or unenforceability of contract rights or the taking of property without fair compensation.

Foreign properties, operations and investments may be adversely affected by local political and economic developments, including nationalization, laws affecting foreign ownership, government participation, royalties, duties, rates of exchange, exchange controls, currency fluctuations, taxation and new laws or policies as well as by laws and policies of Canada affecting foreign trade, investment and taxation. Furthermore, it is important that the Corporation maintain good relationships with the governments in certain of the countries in which it operates. The Corporation may not be able to maintain such relationships if the governments of these countries change. Certain regions in which the Corporation may conduct operations have been subject to political and economic instability. The Corporation's planned capital expenditures are denominated in several currencies, the most important being the Euro and the U.S. dollar, while the Corporation's reporting currency is the Canadian dollar. Fluctuations in the rate of exchange may affect the ability

Management's Discussion and Analysis

of the Corporation to carry out its exploration and development programs. The Corporation does not actively hedge against foreign currency fluctuations. The Corporation's operations are subject to government legislation, policies and controls relating to prospecting, development, production, environmental protection, mining taxes and labour standards.

The petroleum industry is competitive in all its phases. The Corporation competes with numerous other participants in the search for the acquisition of oil and natural gas properties and in the marketing of oil and natural gas. The Corporation's competitors include oil companies which have greater financial resources, staff and facilities than those of the Corporation. The Corporation's ability to increase reserves in the future will depend not only on its ability to develop its present properties, but also on its ability to select and acquire suitable producing properties or prospects for exploratory drilling. Competitive factors in the distribution and marketing of oil and natural gas include price and methods of reliability of delivery.

Both oil and natural gas prices are unstable and are subject to fluctuations. Any material decline in prices could result in the reduction of the Corporation's future net production revenue. The economics of producing from some wells may change as a result of lower prices, which could result in a reduction in the volumes of the Corporation's reserves. The Corporation might also elect not to produce from certain wells at lower prices. All of these factors could result in a material decrease in the Corporation's net production revenue causing a reduction in its oil and natural gas acquisition and development activities. The business and operations of the Corporation will require substantial additional capital. This includes the cost of drilling in Tunisia and the costs of completing the Castor UGS Project. There can be no assurance that the Corporation will continue to have access to sufficient capital, whether by debt or equity financing, to complete such projects. In addition, bank borrowings which might be made available to the Corporation are typically determined in part by the borrowing base of the Corporation. The Corporation will need further development of its projects to establish a borrowing base, based on proved reserves. A sustained material decline in prices from historical average prices could reduce the Corporation's borrowing base, therefore reducing the bank credit available to the Corporation which could require that a portion of such bank debt be repaid.

There are numerous uncertainties inherent in estimating quantities of reserves and cash flows to be derived therefrom, including many factors that are beyond the control of the Corporation. These evaluations include a number of assumptions relating to factors such as initial production rates, production decline rates, ultimate recovery of reserves, timing and amount of capital expenditures,

Management's Discussion and Analysis

marketability of production, future prices of oil and natural gas, operating costs and royalties and other government levies that may be imposed over the producing life of the reserves. Many of these assumptions are subject to change and are beyond the control of the Corporation. Actual production and cash flows derived therefrom will vary from these evaluations and such variations could be material. The Corporation does not have any reserves assigned to its properties and does not have an independent engineering evaluation report under National Instrument 51-101. The Corporation does not currently have any oil or natural gas production. There can be no assurances as to the quantities of oil remaining in the Amposta reservoir. The Corporation has assumed success of exploitation activities intended to be undertaken in future years. Such exploitation activities may not achieve the level of success assumed in the evaluations.

The Castor UGS Project has not yet received all necessary governmental approvals in Spain. There can be no assurance that such approvals will be forthcoming on terms acceptable to the Corporation. The Corporation does not have final project engineering designs for the Castor UGS Project although such will be undertaken in due course. The proposed Castor UGS Project is not operational as of the date hereof and is not anticipated to be operational within the next year. The Corporation has not previously carried on business as an operator of a gas storage facility.

Critical accounting estimates

The preparation of the consolidated financial statements in accordance with Canadian generally accepted accounting principles (GAAP) requires management to make judgements and estimates that affect the financial results of the Corporation. Eurogas' management reviews its estimates regularly but new information and changed circumstances may result in actual results or changes to estimated amounts that differ materially from current estimates. A summary of significant accounting policies is presented in Note 1 to the consolidated financial statements. The critical estimates are discussed below:

Activities in Spain are in the pre-development phase. All pre-development costs relating to the Castor exploration permit in Spain are capitalized. The recovery of these costs is dependent upon the economic viability of the underground natural gas storage project.

The Corporation is currently in the exploratory stage of a drilling program in Tunisia and capitalizes all associated costs. The recovery of the recorded costs is contingent upon the existence of economically recoverable reserves, and future profitable production.

The asset retirement obligation is estimated based on existing jurisdictional laws, contracts or other policies. The fair value of the obligation is based on estimated future costs to abandon and reclaim the Corporation's net ownership interest in all wells and facilities, and the estimated timing of the costs to be incurred in future periods, and is discounted at a credit-adjusted risk-free rate. The liability

Management's Discussion and Analysis

is adjusted each reporting period to reflect the passage of time, with the accretion charged to earnings and for revisions to estimated future cash flows. By their nature, these estimates are subject to measurement uncertainty and the impact on the financial statements could be material.

The determination of the Corporation's income and other tax liabilities requires interpretation of complex laws and regulations, which can involve multiple Canadian jurisdictions. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded.

Disclosure controls and procedures

Disclosure controls and procedures have been designed to ensure that information required to be disclosed by the Corporation is accumulated and communicated to the Corporation's management, as appropriate, to allow timely decisions regarding required disclosures. The Corporation's Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of the end of the period covered by the annual filings, that the Corporation's disclosure controls and procedures are effective to provide reasonable assurance that material information related to the issuer is made known to them by others within the Corporation. It should be noted that while the Corporation's Chief Executive Officer and Chief Financial Officer believe that the Corporation's disclosure controls and procedures provide a reasonable level of assurance that they are effective, they do not expect that the disclosure controls and procedures or internal control over financial reporting will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objective of the control system is met.

Management's Discussion and Analysis

Additional information

Additional information regarding the Corporation and its business and operations is available on the Corporation's company profiles at www.sedar.com. This information is also accessible on the Corporation's website at www.eurogascorp.com.

	2005				
Three months ended	Q1	Q2	Q3	Q4	Annual
Sales, net of royalties					
Discontinued operations	$ 128,575	$ (30,984)	$ 84,550	$ (4,983)	$ 177,158
Funds from (used in) operations					
Continuing operations	(182,840)	(470,753)	115,776	(550,097)	(1,087,914)
Discontinued operations	20,685	(114,210)	19,498	125,014	50,987
Corporate total	(162,155)	(584,963)	135,274	(425,083)	(1,030,927)
Net earnings (loss)					
Continuing operations	(513,288)	(639,055)	(377,683)	(611,772)	(2,141,798)
Discontinued operations	131,890	274,233	18,784	(129,865)	295,042
Corporate total	(381,398)	(364,822)	(358,899)	(741,637)	(1,846,756)
Per share basic and fully diluted	(0.00)	(0.00)	(0.00)	(0.01)	(0.02)
Capital expenditures (gross)	12,157,773	863,930	2,772,949	2,152,079	17,946,731

	2004				
Three months ended	Q1	Q2	Q3	Q4	Annual
Sales, net of royalties					
Discontinued operations	$ 1,934,622	$ 1,731,160	$ 225,564	$ 202,607	$ 4,093,953
Funds from (used in) operations					
Continuing operations	(81,322)	(58,502)	12,990	(645,416)	(772,250)
Discontinued operations	1,087,975	1,068,925	59,542	(10,730)	2,205,712
Corporate total	1,006,653	1,010,423	72,532	(656,146)	1,433,462
Net earnings (loss)					
Continuing operations	45,302	81,182	(426,292)	(812,672)	(1,112,480)
Discontinued operations	318,640	408,344	102,126	94,078	923,188
Corporate total	363,942	489,526	(324,166)	(718,594)	(189,292)
Per share basic and fully diluted	0.00	0.01	(0.00)	(0.01)	(0.00)
Capital expenditures (gross)	2,241,359	1,582,517	3,207,416	3,279,867	10,311,159

Management's Responsibility for Financial Statements

The accompanying consolidated financial statements, the notes thereto and other financial information contained in this annual report have been prepared by, and are the responsibility of, the management of Eurogas Corporation. These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles, using management's best estimates and judgements when appropriate.

The Board of Directors is responsible for ensuring that management fulfills its responsibility for financial reporting and internal control. The Audit Committee, which is comprised of directors, none of whom are employees of the Corporation, meets with management as well as the external auditors to satisfy itself that management is properly discharging its financial reporting responsibilities and to review its consolidated financial statements and the report of the auditors. It reports its findings to the Board of Directors, which approves the consolidated financial statements.

The consolidated financial statements have been audited by Ernst & Young LLP, the independent auditors, in accordance with Canadian generally accepted auditing standards. The auditors have full and unrestricted access to the Audit Committee.

M. Jaffar Khan
President and Chief Executive Officer
April 17, 2006

Andrew Constantinidis
Vice President and Chief Financial Officer

Auditors' Report to Shareholders

To the Shareholders of Eurogas Corporation

We have audited the consolidated balance sheets of Eurogas Corporation as at December 31, 2005 and 2004 and the consolidated statements of operations and retained earnings and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2005 and 2004 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Ernst & Young LLP

Chartered Accountants
Calgary, Alberta
April 17, 2005

Consolidated Balance Sheets

As at December 31	2005	2004
ASSETS		
Current		
Cash and short-term deposits	$ 26,173,723	$ 2,975,897
Accounts receivable	298,383	716,106
Prepaids and other (Note 2)	951,599	621,387
Joint-venture receivable (Note 4(a))	550,966	1,031,820
Rights offering proceeds receivable (Note 9(b))	–	7,554,368
	27,974,671	12,899,578
Notes receivable (Note 3)	1,111,353	1,056,000
Property, plant and equipment (Note 4)	49,323,051	31,859,468
Future income taxes (Note 11)	416,000	95,000
	$ 78,825,075	$ 45,910,046
LIABILITIES		
Current		
Accounts payable and accrued liabilities	$ 3,069,370	$ 2,596,997
Taxes payable	78,436	60,000
Credit facility (Note 6)	100,000	–
	3,247,806	2,656,997
Asset retirement obligation (Note 8)	423,940	179,481
Non-controlling interest (Note 4(a))	3,037,990	1,779,000
	6,709,736	4,615,478
SHAREHOLDERS' EQUITY		
Share capital (Note 9)	66,599,048	34,673,661
Contributed surplus (Note 10)	817,696	75,556
Retained earnings	4,698,595	6,545,351
	72,115,339	41,294,568
	$ 78,825,075	$ 45,910,046

See accompanying notes.

On behalf of the Board

Derek H.L. Buntain
Director

Garth A.C. MacRae
Director

Consolidated Statements of Operations and Retained Earnings

Years ended December 31	2005	2004 (restated – Notes 1 and 7)
REVENUE		
Interest and other	$ 357,293	$ 86,131
EXPENSES		
General and administrative	2,185,358	704,412
Interest	265,895	16,931
Depreciation and accretion	88,051	24,508
Foreign exchange loss	115,435	228,600
Restructuring costs	–	297,040
	2,654,732	1,271,491
Loss from continuing operations before income taxes	(2,297,446)	(1,185,360)
Recovery of income taxes (Note 11)	(155,648)	(72,880)
Loss from continuing operations	(2,141,798)	(1,112,480)
Earnings from discontinued operations, net of tax (Note 7)	295,042	923,188
Net loss	(1,846,756)	(189,292)
Retained earnings, beginning of year	6,545,351	6,734,643
Retained earnings, end of year	$ 4,698,595	$ 6,545,351
Earnings (loss) per common share basic and diluted (Note 9)		
Loss from continuing operations	$ (0.02)	$ (0.01)
Earnings from discontinued operations, net of tax (Note 7)	0.00	0.01
Net loss	$ (0.02)	$ (0.00)

See accompanying notes.

Consolidated Statements of Cash Flows

Years ended December 31	2005	2004
OPERATING ACTIVITIES		
Loss from continuing operations	$ (2,141,798)	$ (1,112,480)
Depreciation and accretion	88,051	24,508
Provision for future income taxes (Note 11)	36,800	22,120
Stock-based compensation expense	573,584	65,002
Unrealized foreign exchange loss	355,449	228,600
Funds used in continuing operations	(1,087,914)	(772,250)
Funds from discontinued operations	50,987	2,205,712
Change in non-cash working capital (Note 13)	(89,416)	1,300,065
Cash provided by (used in) operating activities	(1,126,343)	2,733,527
FINANCING ACTIVITIES		
Issue of share capital, net (Note 9)	31,441,143	7,606,330
Proceeds on issuance of Partnership units (Note 4(a))	1,258,990	–
Acquisition of interest in Partnership units	–	(44,549)
Credit facility (Note 6)	100,000	–
Change in non-cash working capital (Note 13)	7,599,015	(7,468,880)
Cash provided by financing activities	40,399,148	92,901
INVESTING ACTIVITIES		
Disposition of oil and gas properties (Note 4(c))	650,000	51,500
Net investment in oil and gas properties	(17,510,878)	(9,330,840)
Abandonment and reclamation costs incurred	(7,241)	(13,615)
Change in non-cash working capital (Note 13)	1,148,589	–
Cash used in investing activities	(15,719,530)	(9,292,955)
Foreign exchange loss on cash held in foreign currency	(355,449)	(228,600)
Increase (decrease) in cash and short-term deposits	23,197,826	(6,695,127)
Cash and short-term deposits, beginning of year	2,975,897	9,671,024
Cash and short-term deposits, end of year	$ 26,173,723	$ 2,975,897

See accompanying notes.

Notes to the Consolidated Financial Statements

Years ended December 31, 2005 and 2004

1. SIGNIFICANT ACCOUNTING POLICIES

Eurogas Corporation ("Eurogas" or the "Corporation") is an oil and natural gas company with a mandate to create long-term value through the development of high-impact energy projects, including a major underground natural gas storage facility in Spain, and oil and natural gas exploration in Tunisia. These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) and reflect the following policies:

Basis of presentation

Effective June 11, 2004, Eurogas transferred all but two of its Canadian oil and natural gas assets to Great Plains Exploration Inc. ("Great Plains"), pursuant to a Plan of Arrangement described in the Management Information Circular of Eurogas dated April 5, 2004 (the "Arrangement"). The Corporation's remaining Canadian oil and natural gas assets were sold effective May 1, 2005. As such, the results of operations for the Canadian oil and natural gas assets are presented as discontinued operations for all periods presented (Note 7).

Consolidation

The consolidated financial statements include the accounts of the Corporation and all of its subsidiaries.

Foreign currency translation

The Corporation follows the temporal method in accounting for its integrated foreign operations and translates its foreign-denominated monetary assets and liabilities at the exchange rate prevailing at year-end. Non-monetary assets and liabilities are translated at historic rates. Revenues and expenses are translated at the average rate of exchange for the year. Exchange gains or losses are included in operations.

Financial instruments

The Corporation's financial instruments at December 31, 2005 consist of cash and short-term deposits, accounts receivable, joint-venture receivable, notes receivable, accounts payable and credit facility payable. At December 31, 2005 and 2004 the fair value of financial instruments approximated book value due to the near-term maturity or the associated interest rate terms.

Exploration and development expenditures

The Corporation follows the full-cost method of accounting for exploration and development expenditures whereby all costs related to the exploration for and development of oil and natural gas reserves, including asset retirement costs, are accumulated in separate country-by-country cost centers. Costs include lease acquisition, geological and geophysical expenditures, carrying costs of non-productive properties, the drilling of productive and non-productive wells and related plant and production equipment costs, and that portion of general and administrative expenses and interest directly attributable to exploration and development activities. Proceeds received from the disposal of properties are normally deducted from the full-cost pool without recognition of a gain or loss. When such a disposal would alter the depletion and depreciation rate by more than 20 percent, a gain or loss would be recognized.

Notes to the Consolidated Financial Statements

Pre-development costs

The Corporation is currently developing a major underground natural gas storage facility in Spain and capitalizes all costs associated with this project. The project entails the conversion of the abandoned Amposta oilfield to a major natural gas storage facility, following the extraction of existing oil reserves. The recovery of recorded costs is contingent upon economically recoverable reserves, future profitable production and the receipt of necessary governmental approvals in Spain.

In Tunisia, the Corporation is currently in the exploratory stage of its drilling programs and capitalizes all costs associated with the program. The recovery of recorded costs is contingent upon the existence of economically recoverable reserves, and future profitable production.

Ceiling test

The Corporation evaluates its oil and natural gas assets in each reporting period to determine that the costs are recoverable and do not exceed the fair value of the properties. If the carrying value of the oil and natural gas assets is not assessed to be recoverable, an impairment loss is recognized to the extent that the carrying value exceeds the present value of future expected recoverable oil and natural gas volumes. The cash flows are estimated using the future product prices and costs and are discounted using the Corporation's risk-free rate.

Proceeds from the disposition of petroleum and natural gas properties are applied against capitalized costs, except for dispositions that would change the rate of depletion and depreciation by 20 percent or more, in which case a gain or loss would be recorded.

Joint venture activity

Substantially all of the Corporation's exploration, development and production activities are conducted jointly with other entities and, accordingly, the consolidated financial statements reflect only the Corporation's proportionate interest in such activities, unless activity is conducted through a controlled subsidiary, in which case the subsidiary is consolidated with that portion held by others reflected as minority interest.

Revenue recognition

Oil and natural gas sales are recognized when title passes to an external party.

Depletion and depreciation

Depletion of oil and natural gas properties and equipment is computed using the unit-of-production method where the ratio of production to proved reserves, before royalties, determines the proportion of depletable costs to be expensed. Undeveloped properties are excluded from the depletion calculation until quantities of proved reserves are found or impairment occurs. Volumes are converted to equivalent units using the ratio of 1 barrel of oil to 6 mcf of natural gas. Depreciation of office equipment and computer equipment is provided for on a 10 percent and 35 percent declining balance basis, respectively.

Notes to the Consolidated Financial Statements

Asset retirement obligation

The Corporation recognizes the fair value of legal obligations associated with the retirement and reclamation of tangible long-lived assets when the obligation is incurred, with a corresponding increase to the carrying amount of the related assets. This corresponding increase to capitalized costs is amortized to earnings on a basis consistent with depreciation, depletion and amortization of the underlying assets. Subsequent changes in the estimated fair value of the asset retirement obligation are capitalized and amortized over the remaining useful life of the underlying asset. The asset retirement obligation liabilities are carried on the consolidated balance sheet at their discounted present value and are accreted over time for the change in their present value.

Measurement uncertainty

Asset retirement obligation and ceiling test calculations are based on estimates of oil and natural gas volumes and prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the consolidated financial statements of changes in such estimates in future years could be significant.

Stock-based compensation

The Corporation recognizes stock-based compensation expense using the fair value method when stock options with no cash settlement features are granted to employees and directors under the fixed share option plan. Under this method, compensation expense is measured at the grant date and recognized as a charge to earnings over the vesting period with a corresponding credit to contributed surplus. The fair value of the options is determined using the Black-Scholes option pricing model. Upon the exercise of the options, consideration paid by employees or directors together with the amount previously recognized in contributed surplus is recorded as an increase to share capital.

Income taxes

All international projects are in the pre-production stage of development and capitalized costs to date will be available for deduction for income tax purposes in their respective jurisdictions, once commercial operations commence.

The Corporation follows the liability method of accounting for income taxes. Under this method, future tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities, and measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period in which the change is substantively enacted. The future income tax assets are evaluated and if realization is not considered more likely than not, a valuation allowance is provided.

Cash and short-term deposits

Cash and short-term deposits consist of cash and short-term deposits with a maturity of less than 90 days. The interest rate earned on the short-term deposits is approximately 2 percent per annum. At December 31, 2005 the balance of short-term deposits was $356,816 (December 31, 2004 – $nil).

Notes to the Consolidated Financial Statements

Per share information

Basic earnings (loss) per common share are computed by dividing the net earnings (loss) attributable to common shareholders by the weighted average number of common shares outstanding during the period (2005 – 102,178,742; 2004 – 76,244,832). Diluted amounts per common share are calculated using the treasury stock method to determine the dilutive effect of stock options. The treasury stock method assumes that the proceeds received from the exercise of "in-the-money" stock options are used to repurchase common shares at the average market price during the year. The diluted weighted average common shares for 2005 are 104,531,550 (2004 – 79,651,297).

2. PREPAIDS AND OTHER

As at December 31, 2005, the Corporation had Value Added Tax amounts receivable from Spanish Authorities totalling $781,616 (€566,184) related to capital expenditures incurred in Spain during 2005. The balance receivable has been presented as a component of prepaids and other.

3. NOTES RECEIVABLE

During 2002 the Corporation advanced funds aggregating $922,547 to certain unit holders of the Castor UGS Limited Partnership (see Note 4(a)). The advances bear interest at 6 percent per annum, are secured by promissory notes and the respective partnership interests, and are repayable by August 1, 2012. Accrued interest of $188,806 has been included in the balance as at December 31, 2005 (2004 – $133,453). The fair value of the notes approximates the carrying value as reported on the balance sheet.

4. PROPERTY, PLANT AND EQUIPMENT

	2005	2004
Oil and gas properties:		
Spain	$ 30,389,175	$ 13,873,954
Tunisia	18,856,812	17,479,155
Canada	–	436,123
	49,245,987	31,789,232
Other:		
Furniture and fixtures	727,520	642,980
Accumulated depreciation	(650,456)	(572,744)
	$ 49,323,051	$ 31,859,468

Net capital investment during the year by cost center was as follows:

	2005	2004
Spain	$ 16,498,358	$ 5,310,293
Tunisia	1,364,097	736,504
Canada	(351,577)	3,284,042
	$ 17,510,878	$ 9,330,839

Notes to the Consolidated Financial Statements

a) Spain

The Corporation holds a majority interest in the Castor Exploration Permit through Castor UGS Limited Partnership "Castor UGS LP", which was formed in 2001. The Castor Exploration Permit covers the abandoned Amposta oilfield, which is suitable for development as a natural gas storage facility.

In January 2003, an additional 170,722 units in Castor UGS LP were issued by the Partnership to new unit holders for cash consideration of $285,105. Through a series of unit purchases from minority interest owners, Eurogas increased its ownership in Castor UGS LP by 0.4 percent (22,184 units) in September 2004 for $44,549 and by 0.2 percent (16,432 units) in September 2005 for $32,864.

As at December 31, 2005 the Corporation held 72.0 percent of the partnership units.

During 2004, the Corporation entered into an agreement with Escal UGS SL whereby, subject to government approval, a subsidiary of the Corporation, Amposta Resources S.L., agreed to pay 100 percent of hydrocarbon development costs associated with development of the Castor natural gas storage facility (the "Castor UGS Project") in exchange for 100 percent of the hydrocarbons produced, subject to a 5 percent royalty to Escal UGS SL.

The Corporation's Castor UGS Project entails oil extraction and the installation of onshore and offshore gas storage facilities connected by a large diameter subsea pipeline. Eurogas holds a 72.0 percent working interest in the gas storage facility through its ownership in Castor UGS LP and a 100 percent working interest in all hydrocarbons produced on the permit through a 100 percent owned subsidiary.

Costs related to the Castor UGS Project have been capitalized as a component of oil and gas properties, consistent with prior years. Eurogas invested a total of $16.5 million during 2005, including major milestones such as the completion of the Castor #1 drilling program for costs totalling $10.5 million (2004 – $3.9 million) and a 138 sq. km 3D seismic program (2005 – $2.27 million; 2004 – $114,000). During 2005, the Corporation began design activities for the gas storage facilities, investing approximately $2.1 million during the period.

The Corporation capitalized $471,000 of general and administrative expenditures to Spanish asset pools during 2005 (2004 – $385,200).

Minority Unit Holders

As operating partner of Castor UGS LP, the Corporation incurred costs totalling $811,000 during the year (2004 – $1.0 million) which have been allocated to minority unit holders. Minority unit holders are periodically cash-called for their proportionate share of costs associated with the development of the Amposta underground gas storage facility. As at December 31, 2005, $550,966 was receivable from minority unit holders representing costs incurred by Eurogas.

During the second quarter of 2005, minority unit holders were cash-called for a total of $1.3 million (including interest), which represented their portion of costs incurred by Eurogas to April 30, 2005. Cash-call obligations were fulfilled by minority unit holders during the third quarter. Concurrent with the cash call, minority unit holders contributed capital totalling $1.3 million. As a result of the transaction, the Corporation's oil and gas properties increased and non-controlling interest increased by the amount of the capital contribution. Under a Limited Partnership agreement, Eurogas is authorized to request additional capital contributions on a pro-rata basis from minority unit holders and to issue new units in the Limited Partnership as consideration.

Notes to the Consolidated Financial Statements

b) Tunisia

Sfax Permit

Eurogas holds a 45 percent interest in the offshore Sfax Permit which includes 1.0 million acres located in the Gulf of Gabes. During 2005, the Corporation converted the Sfax Seismic Prospecting Permit to an Exploration Permit. This 1.0-million-acre permit, granted for a period of four years commencing December 9, 2005, includes a commitment to drill one exploration well (during the four-year period).

During the year, the Corporation invested $1.1 million on the Sfax Permit including a 3D seismic program completed during the year (2004 – $737,000). The 348 sq. km. 3D seismic survey encompassed two wells that tested oil from separate structures at rates of 1,208 and 612 barrels of oil per day. Mapping of this 3D data confirms the existence of two structures, the Ras El Besh and Jawhara structures, as well as several other large structures.

In addition, the Corporation capitalized $270,000 of general and administrative expenditures to its Tunisian asset pools during 2005 (2004 – $238,900).

El Hamra Permit

The Corporation relinquished its interest in the El Hamra Permit during 2005.

During the third quarter of 2004, the Corporation farmed out 60 percent of its 50 percent interest in the El Hamra Permit. The farmee made an up front payment of US$500,000 and agreed to fund the Corporation's portion of the cost to drill the EH-1 well to a total cost of US$5,000,000, over which the Corporation was responsible for its 20 percent share. The EH-1 well was spudded, drilled, tested and abandoned in the first quarter of 2005 and the Corporation incurred costs totalling $271,674 during 2005, representing its share of total costs in accordance with the farmout agreement.

In 2001 the Corporation entered into an agreement with Pioneer Natural Resources Company (the "Participant") whereby the Participant agreed to fund US$5.2 million of the costs of an exploration drilling program. The balance remaining of US$910,000 (Cdn$1.2 million) was received by the Corporation in January 2004, fulfilling the Participant's funding obligation. The amount received was credited to the Tunisian full-cost pool.

c) Canada

Effective May 1, 2005, the Corporation sold its remaining interests in Canadian oil and natural gas properties for cash consideration of $650,000. A pre-tax gain of $395,757 was booked during the year as follows:

Cash proceeds received	$	650,000
Net book value of Canadian assets		(426,483)
Asset retirement obligation associated with Canadian assets		172,240
Pre-tax gain on sale of Canadian assets	$	395,757

Notes to the Consolidated Financial Statements

5. SEGMENTED INFORMATION

Activities of the Corporation are focused on international petroleum and natural gas exploration and the development of a significant underground natural gas storage project in Spain. The Corporation's total identifiable assets by geographic area, as at December 31, 2005, are as follows:

	2005	2004
Spain	$ 32,386,726	$ 16,342,472
Tunisia	18,903,862	17,479,155
Canada	27,534,487	12,088,419
	$ 78,825,075	$ 45,910,046

6. CREDIT FACILITY

Eurogas holds a $6 million revolving credit facility with Dundee Corporation ("Dundee"), the Corporation's principal shareholder. The credit facility bears interest at the rate of prime plus 2 percent per annum. Interest is payable monthly, in arrears.

Interest expense and standby fees related to the credit facility totalled $214,156 during the year (2004 – $nil). Cash interest paid during the period was equal to interest expense during the period.

7. DISCONTINUED OPERATIONS

Effective May 1, 2005 the Corporation relinquished all interest in its remaining Canadian oil and natural gas properties for cash consideration of $650,000. Operations related to these properties have been disclosed as discontinued operations. Also included, as discontinued operations, are the results from operations related to the other Canadian assets transferred to Great Plains effective June 11, 2004 in accordance with the Arrangement described above.

Notes to the Consolidated Financial Statements

Prior period results have been restated to conform with the presentation adopted in the current period.

	2005	2004
Revenue		
Oil and gas sales, net of royalties	$ 177,158	$ 4,093,953
Interest and other	–	(2,554)
	177,158	4,091,379
Expenses		
Operating	156,625	1,055,780
General and administrative	–	559,751
Interest	–	3,026
Depletion and accretion	31,456	1,003,575
	188,081	2,722,285
Earnings (loss) from discontinued operations before gain on sale of assets and provision for income taxes	(10,923)	1,369,114
Gain on sale of assets (Note 3(c))	395,757	–
	384,834	1,369,114
Provision for income taxes (1)	89,792	445,926
Earnings from discontinued operations, net of tax	$ 295,042	$ 923,188

(1) *The 2005 provision for income taxes includes a refund receivable of $178,208 from Alberta Treasury in respect of the Corporation's 2004 Alberta Income Tax Return.*

8. ASSET RETIREMENT OBLIGATION

The Corporation estimates its total future asset retirement obligation based on its net ownership interest in all wells, the estimated costs to abandon and reclaim such wells, and the estimated timing of the costs to be incurred in future periods.

As at December 31, 2005, the Corporation had net ownership of 72.0 percent in one well, Castor #1, which was drilled during the first half of 2005. Total undiscounted cash flows required to settle the asset retirement obligation of approximately $2.3 million (incurred in 35 years), a credit-adjusted risk-free rate of 5 percent and an inflation rate of 2 percent were used to calculate the fair value of the asset retirement obligation. The following reconciles the Corporation's asset retirement obligation at December 31, 2005:

	2005	2004
Balance, beginning of year	$ 179,481	$ 1,688,600
Revisions in estimated cash flows	–	(51,531)
Liabilities incurred	413,600	–
Liabilities settled	(7,241)	(13,615)
Dispositions	(172,240)	–
Accretion expense	10,340	46,280
Revisions carved out to Great Plains	–	$ (1,490,253)
Balance, end of year	$ 423,940	179,481

(1) Effective May 1, 2005, all ownership interests in Canadian wells and facilities were sold to a third party (see Note 4(c)).

Notes to the Consolidated Financial Statements

9. SHARE CAPITAL

	Number of Shares	Amount
Authorized:		
An unlimited number of common and first preference shares, issuable in series		
Issued and fully paid:		
Common shares, December 31, 2003	75,932.181	$ 35,434,728
Exercise of share options	1,550,000	124,000
Less carve-out to Great Plains	–	(8,467,397)
Repurchase of common shares	(1,482)	(904)
Rights Offering (b)	19,370,778	7,483,234
Forgiveness of share purchase loan (d)	–	100,000
Common shares, December 31, 2004	96,851,477	$ 34,673,661
Exercise of share options (a)	866,667	248,382
Rights Offering (b)(c)	24,348,286	31,577,005
Forgiveness of share purchase loan (d)	–	100,000
Common shares, December 31, 2005	122,066,430	$ 66,599,048

(a) Includes $26,444 related to stock-based compensation that was reclassified from contributed surplus to share capital as the options to which the stock related were exercised during the year.

(b) On December 31, 2004 Eurogas closed a Rights Offering to shareholders to subscribe to 19,370,778 common shares at a subscription price of $0.39 per share. The share issue was fully subscribed raising a total of $7,554,368 and was used to finance the Corporation's drilling and exploration programs in Spain and Tunisia. Costs incurred relating to the offering of $201,025 ($117,725 net of tax) have been recorded as a reduction of share capital during 2005 (2004 – $71,134).

(c) On October 21, 2005, Eurogas closed a second Rights Offering to shareholders to subscribe to 24,348,286 common shares at a subscription price of $1.32 per common share. The share issue was fully subscribed raising a total of $32,139,738. Offering costs of $712,209 ($445,008 net of tax) have been recorded as a reduction of share capital during 2005.

(d) On May 30, 1997 the shareholders of the Corporation approved an arrangement whereby the then Chairman and Chief Executive Officer of the Corporation purchased 1,000,000 common shares of the Corporation at a price of $1.00 per share. The Corporation agreed to provide this officer with a non-interest-bearing loan of $1,000,000 to finance the purchase. At December 31, 2005 the Corporation forgave $100,000 (2004 – $100,000) of the outstanding debt. This amount has been added to share capital and the debt forgiveness is recorded as compensation expense. The $800,000 remaining balance of the loan continues to be deducted from share capital. As a result of the carve-out to Great Plains, the loan is now secured by a pledge of 1,000,000 common shares of the Corporation and 200,000 shares of Great Plains and is repayable out of the proceeds of any sale of the common shares.

Notes to the Consolidated Financial Statements

Net Earnings per Share

The following table summarizes the weighted average common shares and dilutive options used in calculating basic and diluted net earnings per common share:

Years ended December 31	**2005**	2004
Weighted average number of common shares	**102,178,742**	76,244,832
Dilutive options	**2,352,808**	3,406,465
	104,531,550	79,651,297

10. SHARE OPTION PLAN

The Corporation has established a share option plan under which directors, officers, employees and consultants are granted options to purchase common shares of the Corporation. The number of shares issuable under the plan cannot exceed 10,000,000 in total, and the number of shares issuable to any one person under the plan cannot exceed 5 percent of the total number of common shares outstanding from time to time. The exercise price of each option equals the market price of the Corporation's stock on the date of grant and the option's term ranges from five to ten years. A summary of the status of the share option plan is as follows:

	2005		2004	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Opening	**3,791,667**	**$ 0.24**	5,075,000	$ 0.19
Granted	**1,775,000**	**1.53**	400,000	0.32
Exercised	**(866,667)**	**0.26**	(1,550,000)	(0.08)
Cancelled	**–**	**–**	(133,333)	(0.67)
Closing	**4,700,000**	**$ 0.72**	3,791,667	$ 0.24

At December 31, 2005 options to purchase 3,066,667 common shares were exercisable as follows:

Options Price ($)	Options Outstanding	Options Exercisable	Remaining Contractual Life (Years)
0.16	1,150,000	1,150,000	1.5
0.18	1,175,000	1,175,000	0.2
0.32	400,000	266,667	3.6
0.49	150,000	150,000	0.7
1.19	75,000	25,000	4.4
1.26	600,000	50,000	4.3
1.50	200,000	–	4.2
1.59	50,000	50,000	0.2
1.70	300,000	–	4.8
1.76	600,000	200,000	4.2
	4,700,000	3,066,667	

Notes to the Consolidated Financial Statements

Total stock-based compensation expense is amortized over the vesting period of the option. Compensation expense of $573,584 (2004 – $65,002) has been recognized for the year ended December 31, 2005 ($195,000 was capitalized during 2005; $nil during 2004) based on the estimated fair value of the options on the grant date in accordance with the fair value method of accounting for stock-based compensation.

The estimated fair value of share options issued during the period was determined using the Black-Scholes model using the following weighted-average assumptions:

	2005	2004
Risk-free interest rate	5.0%	5.0%
Expected hold period to exercise	5 years	5 years
Volatility in the price of the Corporation's shares	99.9%	107.7%
Dividend yield	0.00%	0.00%

The following table reconciles the Corporation's contributed surplus:

	2005	2004
Balance, beginning of year	$ 75,556	$ 10,554
Stock-based compensation expense	573,584	65,002
Stock-based compensation capitalized	195,000	–
Options exercised	(26,444)	–
Balance, end of year	$ 817,696	$ 75,556

11. INCOME TAXES

The Corporation's future Canadian income tax assets are as follows:

	2005	2004
Temporary differences related to:		
Property, plant and equipment	$ 154,000	$ 5,000
Share issue costs	262,000	20,000
Asset retirement obligation	–	70,000
	$ 416,000	$ 95,000

Notes to the Consolidated Financial Statements

The provision for (recovery of) income taxes differs from the amount computed by applying the combined Canadian federal and provincial tax rate of 37.62 percent (2004 – 38.87 percent) to the loss from continuing operations before taxes of $2,297,446 in 2005 (2004 – $1,185,360). The difference results from the following:

	2005	2004
Computed expected provision for (recovery of) taxes	$ (858,780)	$ (460,749)
Effect on taxes of:		
International operations	519,558	129,106
Other differences	183,574	176,568
Non-deductible restructuring costs	–	82,195
Income tax provision	$ (155,648)	$ (72,880)
Current taxes	(192,448)	(95,000)
Future taxes	36,800	22,120
Provision for (recovery of) taxes	$ (155,648)	$ (72,880)

Costs related to international operations are considered pre-production costs and therefore not subject to tax.

12. RELATED-PARTY TRANSACTIONS

In addition to the related-party transactions described in Notes 6 and 9(d), in 2005 $191,577 was paid to an affiliate of Dundee for services provided as Managing Dealer of the Corporation's two recent Offer of Rights which closed on December 31, 2004 and October 21, 2005. These costs have been included, on a net-of-tax basis, as a reduction of share capital.

Notes to the Consolidated Financial Statements

13. SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Changes in non-cash working capital were comprised of the following:

	2005	2004
Accounts receivable	$ 595,932	$ 3,316,444
Prepaids and other	(330,212)	(288,196)
Joint-venture receivable	480,854	(1,031,820)
Rights offering receivable	7,654,368	(7,554,368)
Notes receivable	(55,353)	(36,062)
Accounts payable, accrued liabilities and taxes payable (recoverable)	312,599	(128,376)
Discontinued operations	–	(446,437)
Change in non-cash working capital	$ 8,658,188	$ (6,168,815)
Relating to:		
Financing activities	$ 7,599,015	$ (7,468,880)
Investing activities	1,148,589	–
Operating activities	$ (89,416)	$ 1,300,065

The Corporation made the following cash outlays in respect of interest expense and income taxes:

	2005	2004
Interest expense	$ 214,156	$ –
Income tax	71,564	–

14. COMMITMENTS

Eurogas has a commitment to drill one well on its Sfax Exploration Permit at a budgeted cost of $7.7 million to the Corporation, which must be completed within the next four years.

Pursuant to the Corporation's office lease arrangements, $301,134 is required over the remaining term of the lease which expires on December 31, 2010.

Various guarantees totalling $33,017 were outstanding at December 31, 2005 (2004 – $871,000).

15. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform with the current year's presentation.

Corporate Information

Directors

Julio Poscente[2]
Chairman of the Board
Calgary, Canada

Ned Goodman[1][2]
Vice Chairman of the Board
Toronto, Canada

M. Jaffar Khan
President & Chief Executive Officer
London, England

Jonathan Goodman
Toronto, Canada

Garth A.C. MacRae[1][2]
Toronto, Canada

Derek H.L. Buntain[1][2]
George Town, Cayman Islands

R. James Kirker
Calgary, Canada

(1) *Audit Committee*
(2) *Compensation Committee*

Officers

M. Jaffar Khan
President & Chief Executive Officer

Bruce W. Sherley
Executive Vice President
& Chief Operating Officer

Andrew E.W. Constantinidis
Vice President
& Chief Financial Officer

Jim Batchelor
Vice President, Exploration

Donald R. Leitch
Corporate Secretary

Auditors

Ernst & Young LLP

Bankers

Scotiabank
Dundee Corporation

Reserves Engineers

GLJ Petroleum Consultants Ltd.
DeGolyer and MacNaughton
Canada Ltd.

Legal Counsel

Carscallen Lockwood LLP

Transfer Agent and Registrar

Computershare Investor Services LLC

Head Office

Eurogas Corporation
250, 435-4th Avenue S.W.
Calgary, AB, Canada T2P 3A8
Tel: (403) 264-4985
Fax: (403) 262-8299
Email: eurogas@eurogascorp.com
Website: http://www.eurogascorp.com

Spain Office

Madrid – Escal UGS SL
San Francisco de Sales 38
28003 Madrid, Spain
Tel: + 34 91 535-7701
Fax: + 34 91 535-2015

Recaredo Del Potro
President and Chief Executive Officer

Tunisia Office

Tunis – Eurogas International Inc.
10 Rue 7000,
Bureau 44, 4e etage
1002 Tunis – Belvedere
Tunisia
Tel: + 216 71 890-551
Fax: + 216 71 782-994
Email: mkassar@gnet.tn

Madame Mélika Kassar
Representative

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EUROGAS CORPORATION

[illegible] Avenue S.W., Calgary, AB Canada T2P 3A8
Tel: [illegible] Fax: (403) 262-3299 Email: eurogas@eurogascorp.com
www.eurogascorp.com